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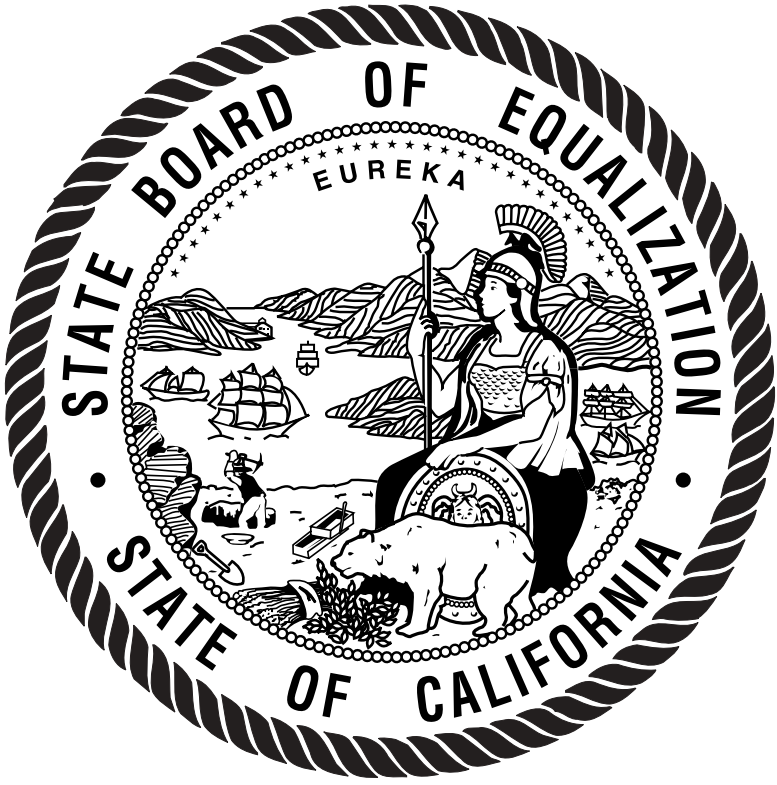

SALES AND USE TAX MEMORANDUM OPINIONS

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ACTION MEDICAL PRODUCTS, INC.

Certain types of continuous passive motion machines are orthotic devices that qualify as exempt medicines.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Late Protest Under the Sales and Use Tax Law of ACTION MEDICAL PRODUCTS, INC.

Appearances:

For Petitioner:	Jacqueline Reynolds President
For Sales and Use Tax Department:	David Levine Tax Counsel IV
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a late protest for the period May 10, 1991, through December 31, 1998. At the Board hearing, taxpayer protested a determination measured by $865,982 for leases of certain types of continuous passive motion machines, leased in the same form as acquired and purchased ex-tax from out-of-state vendors. A physician must order the use of these machines. Patients use the machines for the treatment of injuries and, post-operatively, to deter stiffness and loss of range of motion in joints such as knees and hips. The affected limbs of these patients are strapped into the machines. Powered by electricity, the machines move the affected joints through a controlled range of motion. The taxpayer contended that these continuous passive motion machines qualify as medicines, specifically, orthotic devices exempt under Revenue and Taxation Code section 6369, subdivision (c)(3)(A). If so, the leases are exempt from tax.

The Sales and Use Tax Department contended that, while the machines met all other requirements of a medicine as defined in California Code of Regulations, title 18, section 1591, the machines were orthotic devices that patients did not fully wear on their bodies. Instead, the machines' support stands rested on the floor. The Department contended that it has long been Board policy that, in order to qualify as a medicine, orthotic devices must be fully worn on the body. By amendments to subdivision (b)(4) of section 1591, effective March 10, 2000 and applicable retroactively, the Board clarified that "If any part of the orthotic device is not worn on the person, the device is not a medicine for the purposes of this regulation." However, the Department allowed the medicine exemption for taxpayer's leases of continuous passive motion machines that served the identical medical rehabilitation purpose for other joints, such as elbow and shoulder joints, but were fully worn on the body.

ACTION MEDICAL PRODUCTS, INC. (Contd.)

OPINION

Revenue and Taxation Code section 6369 provides in relevant part:

"(c) . . . 'medicines,' as used in this section means and includes any of the following: ¶ . . . ¶

(3)(A) Orthotic devices . . . designed to be worn on the person of the user as a brace, support, or correction for the body structure . . . . "

Some continuous passive motion machines leased by the taxpayer were exempt, but others were classified as taxable, even though all the machines served the identical medical rehabilitation purpose. We conclude that the continuous passive motion machines at issue in this case qualify as orthotic devices pursuant to section 6369, subdivision (c)(3)(A), although they were not fully worn on the body. Grant the late protest with respect to the disputed transactions.

Adopted at Sacramento, California, on April 18, 2002.

Dean Andal, Member

Claude Parrish, Member

Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

AMF INCORPORATED

Payment by the lessee of tangible personal property of the property taxes related to that property, either directly or indirectly, pursuant to the lease agreement, constitutes gross receipts from the lease of tangible personal property.

A contract to furnish and install bowling alleys constitutes a construction contract for the improvement to realty. Under such a contract, fixtures are regarded as realty. However, where the lessor of fixtures installs them on leased premises of which he/she is not the lessor, and retains a right to remove such fixtures, statutorily the fixtures constitute tangible personal property.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim of AMF INCORPORATED *for Refund of Sales and Use Taxes*

Appearances:

For Claimant: Lewis T. Gardiner, Esq.
Meserve, Mumper & Hughes
J. J. Henry Muller, Esq.
Special Counsel
Joseph Scheer, Manager
Sales and Property Taxes

AMF INCORPORATED (Contd.)

For Staff: Donald J. Hennessy
Tax Counsel
Joseph Manarolla
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of a claim for refund of sales and use taxes in the amount of $100,000 filed by AMF Incorporated (AMF) on October 31, 1974 as an amended claim for refund.

AMF is a New Jersey corporation which manufactures, sells and leases a diversified line of products.

Pursuant to sales and use tax audit covering period 7/11/66 through 6/30/70, Field Billing Order covering period 7/1/70 through 12/31/71, reaudit dated 1/12/76, and amended Field Billing Order dated 1/12/76, an overpayment of taxes by AMF was disclosed. The overpayment was partially offset by deficiencies in tax also disclosed for the above periods, and reduced by grant of partial refund of tax to AMF by warrant No. 6-845386 dated 8/22/74 in the amount of tax of $30,185.13 plus interest of $14,137.08 and warrant No. 4-699145 dated 5/7/76 in the amount of tax of $15,453.10 plus interest of $6,901.09. (Total tax refunded, $45,638.23.)

Of the balance of the claim for refund amounting to $54,361.77 ($100,000 less $45,638.23), AMF protests $10,352.04, representing that portion of the tax liability asserted in the audit and Field Billing Order set off against the claimed overpayment and which is attributable to the following specific items:

(1) Property taxes on leased equipment paid by the lessees and considered as constituting taxable rental receipts of the lessor.

(2) The imposition of the sales tax on the in-place sale of leased bowling lanes considered as constituting the sale of personal property.

The issues raised by the protested items will be discussed in the order listed above.

(1) *Property taxes on leased equipment paid by the lessee.*

The business activities of AMF include the leasing of bowling equipment to operators of bowling alleys and the leasing of orbitread machines used in tire recapping.

Under the terms of the lease agreements involved here, the lessees are obligated to pay the property taxes assessed against the leased equipment. Generally, the lessee is the assessee and pays the taxes directly to the taxing authority.

AMF has contended that the property taxes assessed against the leased equipment, to the lessee and paid by the lessee, are erroneously and illegally regarded by the Board as constituting taxable rental receipts of the lessor.

The issue raised is not new to the Board. It has been the Board's consistent position that payment by the lessee of the property taxes either directly or indirectly pursuant to the lease agreement constitutes gross receipts from the

AMF INCORPORATED (Contd.)

lease of the property. The issue currently is the subject of litigation (*Machinery Leasing Co.* v. *State Board of Equalization,* Los Angeles Superior Court No. C146797). Until the issue has been finally adjudicated, the Board's position remains unchanged.

(2) *The "in-place" sale of leased bowling lanes.*

This item concerns two sales by AMF of leased bowling lanes and related equipment in place located on the premises of (a) Friendly Hills Lanes and (b) Montebello Lanes. The lanes and related equipment (hereinafter bowling alleys) were leased by AMF to lessees who held the underlying lease on the premises. The leased premises upon which bowling alleys were installed were not owned by the purchasers of the bowling alleys and AMF was not the lessor of the premises.

The lease agreements under which the bowling alleys were leased expressly provided that the leased bowling alleys remained personal property, with ownership and title being retained by AMF (lessor). Copy of sample lease submitted for our consideration (copy in file) provides at Article 6(g):

> "The machines shall at all times remain the sole and exclusive property of AMF (which reserves the right to assign or encumber the machines) and Operator (lessee) shall have no right, title or interest to the machines but only the right to use them under this agreement. . . ."

At the time of the sale of the subject bowling alleys, AMF was the owner of the lanes which remained personal property under the lease, and clearly possessed the right to remove its property from the leased premises. It is relevant that the "Purchase Order and Conditional Sales Contract" entered into for the sale of the bowling alleys (copy in file) expressly provides that the purchaser "agrees to purchase the equipment described below". It is also relevant that the described "equipment" includes:

> "16 pr. AMF Magic Circle *Bowling Lanes* with Underlane Ball Returns, Score Projectors attached and *Sub-Foundations*." (Emphasis added.)

The contract further provides that:

> "Title to and ownership of said equipment . . . shall remain in Seller . . . until all of the above payments have been fully made. . . . Said equipment shall *remain chattels and personal property* at all times." (Emphasis added.)

The audit has regarded the sales of the bowling alleys as constituting a sale of tangible personal property subject to the tax (Section 6006, Revenue and Taxation Code). The sales price was adjusted by reaudit of 1/12/76 to give effect to the in-place value of the bowling alleys pursuant to Regulation 1596(c).

AMF contends that that portion of the property sold consisting of the "lanes" constitute realty the sale of which is not subject to the tax.

For purposes of clarification, the "lanes" in question here consist of the hardwood flooring lumber, including the sub-foundations to which it is secured and which extends from the ball return equipment at one end to the pinsetting equipment at the other end, and upon which the bowling ball rolls to the pins. The lanes are constructed of a different type of material than the regular floor of the

AMF INCORPORATED (Contd.)

building and are installed to perform a specific function completely different from that of an ordinary floor. Clearly, the hardwood is not designed for nor intended to be walked upon as a part of the flooring of the building. The lanes do not lose their identity as an accessory to the building.

Bowling alleys have consistently and for a long time been classified by the Board as ''fixtures'' within the meaning of Regulation 1521, which defines fixtures as follows:

> ''Fixtures means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed.''

Accordingly, a contract to furnish and install bowling alleys constitutes a construction contract for the improvement to realty. Under such a contract, fixtures are regarded as realty. However, where the lessor of fixtures installs them on leased premises of which he is not the lessor, and retains a right to remove such fixtures, statutorily the fixtures constitute tangible personal property. Section 6016.3 of the Revenue and Taxation Code provides:

> ''Leased fixtures. 'Tangible personal property', for the purposes of this part, includes any leased fixtures if the lessor has the right to remove the fixtures upon breach or termination of the lease, unless the lessor is also the lessor of the realty.''

The statute clearly applies in the instant case.

AMF argues, however, that the Board's classification of bowling lanes as fixtures is erroneous.

The argument is not convincing. The case of *Trabue Pittman Corp.* v. *County of Los Angeles*, 29 Cal.2d 385, a property tax case, cited by AMF in support of its argument was expressly distinguished by the court in *Standard Oil Co.* v. *State Board of Equalization*, 232 Cal.App.2d 91, as not applicable to sales and use tax matters in the classification of property as real or personal. The Board's classification of property for sales and use tax purposes has been judicially approved as has the validity of Regulation 1521. (See *Oliver and Williams Elevator Corp.* v. *State Board of Equalization*, 48 Cal. App. 3d 897; *Honeywell Inc.* v. *State Board of Equalization*, 48 Cal.App.3d 897.)

Furthermore, the leased bowling alleys here involved were by agreement and intent of the parties to remain personal property even though affixed to realty. The agreed classification of the property as personalty also was expressly provided for in the agreement of sale.

> ''Equipment in the nature of trade fixtures, unaffixed by the seller but intended to be affixed by the buyer, or equipment affixed by the seller but to become unaffixed on the sale, is tangible personal property subject to the sales tax; it cannot be conceived that the Legislature intended gross receipts from the sale of the very same property should escape taxation simply because, though removable by the owner as a matter of right, the equipment was sold in place with a present intent that it remain there.'' (*Standard Oil Co.* v. *State Board of Equalization*, 232 Cal.App.2d 91.)

AMF INCORPORATED (Contd.)

It is concluded that the sales of the bowling alleys constitute sales of tangible personal property subject to the sales tax.

For the reasons expressed in this opinion, the claim for refund, to the extent of $54,361.77, is denied.

Done at Sacramento, California, this 6th day of April 1977.

William M. Bennett, Chairman
George R. Reilly, Member
Richard Nevins, Member
Iris Sankey, Member
Attested by: W. W. Dunlop, Executive Secretary

B & D LITHO, INC.

An out-of-state taxpayer that voluntarily registered to collect the use tax on its sales to California customers was obligated to do so until it both cancelled its certificate and did not engage in activities constituting nexus.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of B & D LITHO, INC.

Appearances:

For Petitioner:	Steven Gaynor President
For Sales and Use Tax Department:	Warren Astleford Supervising Tax Counsel
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period July 1, 1993 through June 30, 1996. At the Board hearing, petitioner protested a portion of a determination related to its sales to California customers.

Petitioner, an out-of-state corporation, manufactured and sold customer business forms. Petitioner reported its sales at retail to California customers and paid its use tax collections from those customers pursuant to its Certificate of Registration—Use Tax. It had applied for and received its certificate before the audit period, and its certificate was active during the entire audit period. Among other things, petitioner contends that it did not have sufficient activities in this state to be engaged in business (nexus) for purposes of use tax collection during the audit period.

B & D LITHO, INC. (Contd.)

OPINION

California Code of Regulations, title 18 (Regulation), section 1684, Collection of Use Tax by Retailers, sets out the requirements for out-of-state retailers to collect use tax on their retail sales to California customers. Subdivision (a) of that regulation describes some of the activities that will constitute being engaged in business in this state for purposes of use tax collection, pursuant to Revenue and Taxation Code section 6203.

Subdivision (b) of Regulation 1684 provides:

"(b) RETAILERS NOT ENGAGED IN BUSINESS IN STATE. Retailers who are not engaged in business in this state may apply for a Certificate of Registration—Use Tax. Holders of such certificates are required to collect tax from purchasers, give receipts therefor, and pay the tax to the board in the same manner as retailers engaged in business in this state."

Since petitioner had a Certificate of Registration—Use Tax issued by the Board during the entire audit period, it is irrelevant whether petitioner had sufficient activities in this state to be engaged in business during the audit period. Having voluntarily registered to collect the use tax on its California sales, it was obligated to do so until it both cancelled its certificate and did not engage in activities constituting nexus. The petition should be denied as to this issue.

Adopted at Sacramento, California, on May 31, 2001.

Claude Parrish, Chairman

John Chiang, Member

Johan Klehs, Member

Dean Andal, Member

Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

BARNES & NOBLE.COM

Taxpayer arranged for the California locations of its corporate relative to hand out its coupons in bags given to customers of the relative. The Board concluded that this activity was "selling" for purposes of subdivision (c)(2) of Revenue and Taxation Code section 6203, and that taxpayer was thus required to collect California's use tax as a retailer engaged in business in this state.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of BARNES & NOBLE.COM

Appearances:

For Petitioner: George S. Isaacson
Attorney at Law

BARNES & NOBLE.COM (Contd.)

For Sales and Use Tax Department: David H. Levine
Tax Counsel IV

For Appeals Section: John Abbott
Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period November 15, 1999, through March 31, 2000. At the Board hearing, petitioner protested a determination related to petitioner's sales to California purchasers.

Petitioner is a Delaware limited liability company known as ''barnesandnoble.com llc.'' Petitioner makes online retail sales of tangible personal property (e.g., books, videos, music and computer software) via the Internet. The goods petitioner sells to California purchasers are delivered by common carrier or by United States mail from outside California. Petitioner alleges that it is a separate and distinct legal entity from Barnes & Noble Booksellers, Inc. (hereafter Booksellers), an affiliated corporation that sells similar goods in ''brick-and-mortar'' stores throughout the country, including California. Petitioner alleges that it did not maintain, occupy or use any place of business in California during the audit period at issue. (See Rev. & Tax. Code, § 6203, subd. (c)(1).) Petitioner was not registered with the Board during the period in question and, thus, filed no sales and use tax returns related to this period.

The Sales and Use Tax Department (Department) asserts that petitioner was a retailer engaged in business in this state during the period in question based on the following known facts: Some time in mid-November 1999, Booksellers began distributing in California discount coupons for purchases made through petitioner's web site (hereafter the coupons). Booksellers's customers received the coupons as an insert in the shopping bags into which their purchases from Booksellers were placed by Booksellers's employees. The coupons offered a $5 discount on a purchase from petitioner of $25 or more, exclusive of handling and shipping charges, with certain restrictions. Each coupon could only be used once, and each of petitioner's customers could only use one coupon during the offer period, which expired on January 31, 2000. The coupons contained an alphanumeric ''coupon claim code,'' which purchasers had to enter on line to obtain the discounted price. The coupons were limited to online transactions with petitioner, and the coupons could not be used for purchases made at Booksellers's stores.

Petitioner paid for the printing of the coupons Booksellers distributed, and the coupons were placed in special promotional shopping bags that had the ''Barnes & Noble'' logo printed on one side and petitioner's ''bn.com'' logo on the other. Petitioner paid for the costs associated with printing petitioner's logo on the bags. These bags were then shipped to New Jersey where a third party inserted the coupons for a fee, which petitioner paid. Finally, the coupon-containing, cross-promotional bags were then shipped from New Jersey to Booksellers's

BARNES & NOBLE.COM (Contd.)

stores throughout the country, including California. Booksellers's stores were notified that they were to receive the special bags with the coupons on November 12, 1999, and that these bags and coupons should be distributed only until December 19, 1999.

OPINION

With certain exceptions that are not relevant to this matter, Revenue and Taxation Code section (hereafter Section) 6203 imposes a use tax collection obligation on ''. . . every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state. . .'' Under subdivision (c)(2) of Section 6203, the meaning of ''retailer engaged in business in this state'' includes:

> ''[a]ny retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.''

When, as here, no dispute exists with respect to an out-of-state seller's status as a retailer, three additional requirements must be satisfied for the seller to be a ''retailer engaged in business in this state'' under Section 6203, subdivision (c)(2).

First, the out-of-state retailer must have a representative, agent, salesperson, canvasser, independent contractor or solicitor (hereafter, collectively, representative). Second, this representative must be operating in California under the authority of the out-of-state retailer or its subsidiary (i.e., the in-state representative must be authorized to act on the out-of-state retailer's behalf). Third, the out-of-state retailer's authorized representative's operations in California must include one of the following activities: selling, delivering, installing, assembling or taking orders for tangible personal property. Applying this analysis to the instant matter, these three requirements are met if: (1) Booksellers was petitioner's authorized representative in this state for purposes of distributing petitioner's coupons; and (2) the distributing of such coupons constitutes ''selling.'' [1] The first issue is a matter of fact, the second is a matter of law.

1. Authorized Representative

As to the first issue, the available evidence suffices to establish that, for the audit period, Booksellers was petitioner's authorized representative in this state for the purpose of distributing the coupons. As indicated above, by petitioner's own admission, petitioner paid the costs both for printing the coupons and for stuffing the coupons into the cross-promotional shopping bags. Petitioner implicitly acknowledges that petitioner had some role in authorizing when and how long Booksellers distributed the coupons because petitioner alleges that

[1] The Department has not alleged that Booksellers, during the period at issue, engaged in any activities on petitioner's behalf in California that would constitute ''delivering, installing, assembling, or the taking of orders for any tangible personal property'' as these terms are used under subdivision (c)(2) of Section 6203.

BARNES & NOBLE.COM (Contd.)

Booksellers was instructed to distribute the coupons for only a limited period of time. When the authorized period of distribution was over, Booksellers was apparently obligated to dispose of any remaining coupon-containing bags. Finally, petitioner honored the redemption of the coupons distributed by its authorized representative, which it would not have done had their distribution by Booksellers not been authorized by petitioner.

In sum, pursuant to petitioner's authorization, Booksellers's employees in California handed customers shopping bags that were emblazoned with petitioner's logo and that contained petitioner's coupons. This conduct served as a public statement that Booksellers had the authority to distribute the coupons on petitioner's behalf. Because the distribution of the coupons occurred, among other places, in California, this conduct also suffices to establish that Booksellers was petitioner's authorized representative in this state for this purpose.

2. Selling Activity

As to the legal issue that remains, because it was accomplished through an authorized representative, the distribution of coupons, under the facts of this case, constitutes ''selling'' under subdivision (c)(2) of Section 6203. Because neither the Sales and Use Tax Law in general, nor Section 6203 in specific, contains a definition of ''selling,'' following the accepted canons of statutory construction, this term should be construed according to its common usage. In other words, ''selling'' is inclusive of all activities that are an integral part of making sales. (See Board's recent Memorandum Opinion, *Borders Online, Inc.* (adopted September 26, 2001), hereafter *Borders*.)

Petitioner has argued that ''selling'' should have the same meaning as ''sale,'' which is defined in Section 6006 (i.e., petitioner contends that one is not ''selling'' unless one transfers title or possession of tangible personal property for consideration). Although unable to cite any dispositive authority for this contention, petitioner argues that such a construction would be consistent with California statutory and common law and with *Borders*. We disagree, because the definition of ''selling'' in *Borders* (i.e., ''all activities that are an integral part of making sales'') is entirely consonant with the plain language of Section 6203(c)(2) and with dictionary definitions of ''selling.'' (See, e.g., American Heritage Dict. (3d college ed. 1993) p. 1238.)

Specifically, Section 6203(c)(2) provides that retailers are engaged in business in California if they have ''any [authorized] representative, agent, salesperson, canvasser, independent contractor, or solicitor'' operating in California ''for the purpose of selling, delivering, installing, assembling, or taking orders for any tangible personal property.'' Petitioner argues that, under Section 6203(c)(2), ''selling'' cannot include the activities of ''offering for sale'' or ''solicitation'' because, according to petitioner, ''selling'' only occurs when title to, or possession of, tangible personal property is transferred for consideration. (See Rev. & Tax. Code, § 6006.) In other words, according to petitioner, in-state representatives that only solicit sales are not ''selling,'' even if their solicitations result in sales. If this were the case, as to transactions subject to use tax where no nexus basis besides Section 6203(c)(2) exists, out-of-state retailers could avoid

BARNES & NOBLE.COM (Contd.)

California use tax collection obligations merely by having their in-state sales representatives avoid delivering, installing, assembling or taking orders for tangible personal property (e.g., by instructing the purchasers to use the mail, telephone or Internet to place orders with a particular out-of-state retailer in response to the in-state representative's solicitations, with delivery directly to the purchasers via common carrier). It strains credulity to argue that such in-state sales representatives are not acting on behalf of out-of-state retailers ''for the purpose of selling . . . tangible personal property.'' (See Rev. & Tax. Code, § 6203, subd. (c)(2).) Moreover, all reputable dictionary definitions of ''selling'' (under the term ''sell'') include ''offering for sale'' within the standard meanings of the term. (See, e.g., American Heritage Dict. (3d college ed. 1993) p. 1238.)

Thus, petitioner's argument that ''selling'' under Section 6203(c)(2) should have exactly the same meaning as ''sale'' under Section 6006 is unfounded. We further note that petitioner's argument acknowledges that the Sales and Use Tax Law does not define the term ''selling.'' (See Rev. & Tax. Code, §§ 6002–6024.) Moreover, petitioner has not cited any appellate case applying the Sales and Use Tax Law that defines ''selling'' or suggests that ''selling'' and ''sale'' should be treated as the same word. At the risk of belaboring the obvious, ''sale'' and ''selling'' are not the same word and, while clearly cognates, both words have their own distinct meaning. As noted above, in common usage, ''selling'' is understood to be inclusive, among other things, of ''offering for sale.'' In short, the *Borders* definition of ''selling'' (i.e., ''all activities that are an integral part of making sales'') fairly captures the common understanding of the activity of ''selling.''

Thus, in the instant matter, Booksellers's employees physically handed coupons for discounted sales directly to petitioner's existing and potential customers. Indeed, the sales at issue could not have been made as bargained for without the distribution of the coupons in question because, as petitioner concedes, the purchaser had to enter the alphanumeric ''coupon claim code'' printed on the subject coupons to complete the offer to purchase at the discounted price. Such conduct, as part of a nation-wide marketing campaign, was integral to petitioner's selling efforts during the period of coupon distribution, which coincided with the end-of-the-year holiday shopping season. Nothing is more integral to an out-of-state retailer's selling efforts than, as here, an authorized, in-state representative's solicitation of in-state customers. Thus, petitioner was engaged in business in this state. (See Rev. & Tax. Code, § 6203, subd. (c)(2).)

Moreover, we disagree with petitioner's argument that Booksellers's authorized coupon distribution was ''mere advertising,'' not ''selling'' through an authorized in-state representative. While it is understood that ''mere advertising'' in California does not make an out-of-state seller a retailer engaged in business in this state, as explained below, Booksellers's conduct in California on petitioner's behalf cannot be fairly characterized as ''mere advertising.'' Accordingly, petitioner's argument is unavailing.

In the parlance of the advertising industry, an ''advertisement'' is a ''written, verbal, pictorial, graphic, etc., announcement of goods or services for sale, employing purchased space or time in print or electronic media.'' (Wiechmann,

BARNES & NOBLE.COM (Contd.)

NTC's Dictionary of Advertising (2d ed. 1993) p. 4.) ''Advertising'' is a subset of ''marketing,'' which encompasses all ''business activities that affect the distribution and sales of goods and services from producer to consumer.'' (*Id.* at p. 108.)

Here, Booksellers is not a media vehicle (e.g., radio, television, cable television, newspapers, magazines, billboards, etc.), and petitioner did not ''purchase space'' in and on Booksellers's shopping bags. In fact, petitioner has not alleged that it made any payments to Booksellers at all. Rather, the evidence shows that petitioner and Booksellers engaged in a joint marketing effort targeted at their common customer base, with petitioner covering the printing costs of participating in this joint marketing effort.

In short, the use of the employees of an authorized in-state representative to make sales solicitations by manual transmission of coupons cannot reasonably be characterized as ''mere advertising.'' Booksellers's conduct in California on petitioner's behalf is clearly distinguishable from sellers who purchase space in a media vehicle, like a newspaper, to distribute coupons to existing and potential customers. Hence, Booksellers's authorized coupon distribution in this state constituted a ''selling'' activity on petitioner's behalf under subdivision (c)(2) of Section 6203.

The fact that petitioner's authorized representative, Booksellers, only distributed petitioner's coupons corroborates that it is a selling activity, rather than mere advertising. (Cf. *Borders*, finding an in-state, authorized representative's preferential return policy, favoring customers of an out-of-state retailer, to be a selling activity.)

In *Quill Corp.* v. *North Dakota* (1992) 504 U.S. 298 [hereafter *Quill*], the United States Supreme Court held that, pursuant to the Commerce Clause of the United States Constitution, a state cannot impose a use tax collection obligation on out-of-state retailers unless those retailers have ''substantial nexus'' with that state. The *Quill* court explained that, to establish commerce-clause nexus, a state must show that the out-of-state retailer, or a representative of the out-of-state retailer, has a sufficiently substantial physical presence in the state to justify the imposition of a use tax collection obligation. (*Ibid.*) In this case, petitioner had a substantial physical presence in California through the many places of business and employees of Booksellers, petitioner's authorized representative in this state for the purpose of selling tangible personal property. Petitioner's substantial physical presence in this state more than suffices to establish that petitioner had commerce-clause nexus with California during the coupon distribution period. (See *ibid.*)

In sum, the evidence is sufficient to establish that Booksellers, acting as petitioner's authorized representative, distributed the coupons for petitioner in California during the audit period. Such solicitation activities were an integral part of petitioner's selling tangible personal property. Therefore, due to Booksellers's actions in California as petitioner's authorized in-state representative, petitioner was a ''retailer engaged in business in this state'' during

BARNES & NOBLE.COM (Contd.)

the audit period. Accordingly, petitioner was obligated to collect, and remit, use tax from petitioner's California customers during the audit period. (Rev. & Tax. Code, §§ 6203, subds. (a) & (c)(2), 6204.)

Adopted at Sacramento, California, on September 12, 2002.

Dean Andal, Member
Johan Klehs, Member
Claude Parrish, Member

GEORGE BAJCZY

Where there is a business purpose for carrying out a transaction in steps, the tax implications of the individual steps will not be ignored.

Where a person who was a partner in a partnership which was dissolved sells assets of the former partnership, the sale is an exempt occasional sale if the person has not made other sales within a twelve month period.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of GEORGE BAJCZY dba PRECISION MACHINED PARTS CO. *for Redetermination of Sales Tax*

Appearances:

For Petitioner: Lawrence S. Wayne
Attorney at Law

For Staff: W. E. Burkett
Tax Counsel

MEMORANDUM OPINION

This opinion considers the petition of George Bajczy for redetermination of a sales and use tax deficiency determination in the amount of $1,415.68 plus statutory interest. The tax is measured by the audited sales price of tangible personal property considered to have been sold at retail on December 20, 1966.

Petitioner was formerly associated with a Mr. Dave Watanabe in a partnership which operated a machine shop. A seller's permit was required for the operation of the business activity. The parties encountered difficulties in the operation of the business and a decision was made to dissolve the partnership. Petitioner located three other individuals who were interested in investing in the business if petitioner could secure the interest of Mr. Watanabe.

On December 20, 1966, petitioner acquired Mr. Watanabe's 50 percent interest in the partnership including his interest in the partnership assets for the sum of $3,000 plus an agreement to assume all liabilities and obligations incurred on behalf of the partnership. On this same date petitioner sold a 50 percent interest in the business to the three individuals for the amount of $4,312 subject to the existing business liabilities. Petitioner and the three other individuals subsequently transferred the business to a commencing corporation in exchange for stock and other consideration.

GEORGE BAJCZY (Contd.)

The staff considered the transfer from petitioner to the three individuals to be a retail sale subject to the sales tax and assessed tax measured by the audited sales price of the tangible personal property assets transferred (per former sales and use taxes ruling 81 [new regulation 1595]).

It is petitioner's contention that the transfer to petitioner was not a sale because it was only a step in the process of making the transfer to the corporation and for the additional reason that petitioner received no economic gain (consideration) from the intervening transfer. This latter contention is founded upon the claim that petitioner was required to retain all excess purchase funds for use in the operation of the business. If the transfer from petitioner to the three individuals is held to be a sale then it is submitted that the transfer qualifies as an occasional sale. This alternative ground for exemption is based upon the contention that the property sold by the petitioner was not held or used in an activity for which a seller's permit was required (Revenue and Taxation Code section 6006.5(a)).

A determination that the transfer of the property to three individuals in form was merely a step in the process of making a transfer to a new corporation and not a separate sale is dependent upon a finding that there was no business purpose for the separate transfer (see *Gregory* v. *Helvering*, 293 U. S. 465). We believe a finding that there was a business purpose for the separate transfer is warranted. Since Mr. Watanabe did not consent to a transfer of the partnership assets to a corporation it was necessary for petitioner to acquire the interest of Mr. Watanabe before the business could be transferred to the corporation. In order to obtain the funds to buy out Mr. Watanabe petitioner contracted with the three individuals to transfer Mr. Watanabe's interest to them. There is no indication that the three individuals agreed to advance the funds without consideration and the corporation did not have any assets to fund the purchase. It is, therefore, evident that the agreement to transfer an interest to the three individuals was essential to the petitioner's acquisition of Mr. Watanabe's interest. Additionally, petitioner, in his individual capacity, received a consideration which differed from the consideration paid to Mr. Watanabe. The corporation did not participate in this bargain and sale transaction.

The contention that petitioner did not receive consideration because of the requirement that the excess purchase funds be used in the business is without merit. Such a contractual restriction does not disqualify a benefit as consideration given for a sale so long as the recipient acquires the use and benefit of the property through his ownership interest in the corporation. The classification of a transaction as a sale for sales tax purposes is not precluded by the absence of profit on the transfer (*Union League Club* v. *Johnson*, 18 Cal.2d 275).

The remaining question is whether the transfer qualifies as an occasional sale under the provisions of section 6006.5(a) of the Revenue and Taxation Code. In order to qualify as an occasional sale under this provision of the statute it is required that the property not be held or used in an activity for which a seller's permit was required and that the subject transfer not be one of a series of sales sufficient in number, scope, and character to require the holding of a seller's permit.

GEORGE BAJCZY (Contd.)

Upon acquiring the interest of Mr. Watanabe the petitioner held the entire ownership interest in business assets which had been held and used in an activity for which a seller's permit was required. However, the business activity was actually carried on by a separate jural person, the partnership. Petitioner did not engage in any business activity in his individual capacity prior to the sale nor did he make any other retail sales of tangible personal property in his individual capacity.

Having found that there was a good business purpose for the separate transfers, we conclude that petitioner's single sale of assets to the three individuals qualified as an occasional sale under section 6006.5(a) of the code and is exempt from taxation under the provisions of section 6367.

Done at Sacramento, California, this 8th day of December 1970.

George R. Reilly, Chairman
John W. Lynch, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

BERGEN BRUNSWIG DRUG COMPANY

A drug company's sales of prescription medicines to surgery centers qualified as exempt sales, even though the surgery centers were not health facilities as defined for purposes of the exemption, since physicians furnished the medicines to their patients at the surgery centers.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of BERGEN BRUNSWIG DRUG COMPANY

Appearances:

For Petitioner:	Rick Richman Representative
	Kirk Merriman Manager
For Sales and Use Tax Department:	Sharon Jarvis Senior Tax Counsel
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period April 1, 1994, through March 31, 1997. At the Board hearing, petitioner

BERGEN BRUNSWIG DRUG COMPANY (Contd.)

protested a portion ($838,430.55) of a determination representing disallowed claimed exempt sales of prescription medicines to surgery centers, established by block sample.

Petitioner sold prescription medicines to surgery centers, hospitals, clinics, and drug stores. The surgery centers did not qualify as health facilities (e.g., hospitals) as defined under Health and Safety Code section 1250 since patients were not admitted for a period of 24 hours or longer. At the surgery centers, physicians performed medical procedures and had the medicines administered to their patients. The surgery centers did not sell the medicines to the physicians, and the surgery centers generally did not have pharmacies or bill the medicines to the patients separately from medical services.

The Sales and Use Tax Department contended that tax applied to petitioner's sales of prescription medicines to surgery centers since none of the exemptions from tax applied under Title 18, California Code of Regulations, section 1591, paragraph (d) (hereafter ''section 1591''). Since the surgery centers did not sell the medicines to their physicians, the physicians could not have furnished the medicines for the treatment of their patients. Instead, the surgery centers, as the purchasers of the medicines from petitioner, furnished the medicines. There is no exemption currently available for sales of prescription medicines to surgery centers, rather than qualified health facilities, that furnish medicines for treatment of persons.

OPINION

As relevant to this opinion, section 1591 provides in part:

''(a) [¶ . . .¶]

(3) FURNISH. 'Furnish' means to supply by any means, by sale or otherwise.[¶ . . . ¶]

''(d) APPLICATION OF TAX—IN GENERAL. Tax applies to retail sales, including over-the-counter sales of drugs and medicines, and other tangible personal property by pharmacists and others. However, tax does not apply to the sale or use of medicines when sold or furnished under one of the following conditions:

(1) prescribed for the treatment of a human being by a person authorized to prescribe the medicines, and dispensed on prescription filled by a pharmacist in accordance with law, or

(2) furnished by a licensed physician, dentist or podiatrist to his or her own patient for treatment of the patient, or

(3) furnished by a health facility for treatment of any person pursuant to the order of a licensed physician, dentist or podiatrist, or

(4) sold to a licensed physician, dentist, podiatrist or health facility for the treatment of a human being . . .''

We conclude that petitioner's sales of prescription medicines to surgery centers qualify as exempt sales of medicines under section 1591, paragraph (d)(2) above. Even though the surgery centers were not health facilities as defined under Health

BERGEN BRUNSWIG DRUG COMPANY (Contd.)

and Safety Code section 1250, and did not sell the medicines to their physicians, the physicians did furnish the medicines to their patients as part of the medical procedures the physicians performed at the surgery centers. As provided above, ''furnish'' means to supply by any means, by sale or otherwise. It was not necessary for the surgery centers to first sell the medicines to their physicians before the physicians were authorized to furnish them to their patients as part of the medical procedures. Thus, petitioner sold the prescription medicines at issue to the surgery centers so that their physicians could furnish the medicines to their patients for the treatment of those patients.

Grant the petition with respect to the disputed transactions.

Adopted at Sacramento, California, on December 20, 2001.

Claude Parrish, Chairman
John Chiang, Member
Dean F. Andal, Member
Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

BOMBARDIER, INC.

Claimant sold sixteen rail passenger cars to the North San Diego County Transit Development Board (NTCD) which is a public agency which provides bus and rail mass transportation services in the San Diego area. The cars were for use on the "Coaster" commuter train operating between Oceanside and San Diego on 43 miles of track which was partially owned by NCTD. The track is also used by other interstate passenger and freight trains.

The cars were manufactured outside of California and delivered in California by common carrier. Claimant paid use tax to this Board and filed a claim for refund. The Board concluded that the purchases and sales of rail cars qualify for exemption under Revenue and Taxation Code section 6352, which allows exemption for tangible personal property that this State is prohibited from taxing under the laws of the United States. Federal law (the "4-R Act", 49 U.S.C. section 11501 and former section 11503(b)) prohibits state taxation "that discriminates against a rail carrier providing transportation subject to the jurisdiction of [the Interstate Commerce Commission or the Surface Transportation Board]."

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim for Refund of BOMBARDIER, INC. *under the Sales and Use Tax Law:*

Appearances:

For Claimant: Mr. W. Scott Williams
Counsel for NCTD
Mr. Frederick A. Richman
Counsel for SCRRA

BOMBARDIER, INC. (Contd.)

For Business Taxes Appeals Section, Legal Division:	Ms. Susan M. Wengel Assistant Chief Counsel
For Sales and Use Tax Department:	Mr. Gary Jugum Assistant Chief Counsel
	Ms. Janice Thurston Tax Counsel
	Mr. Kevin Hanks Hearing Representative

MEMORANDUM OPINION

This opinion considers the merits of a claim for refund under the Sales and Use Tax Law for the period October l, 1994, through June 30, 1995, in the amount of $1,805,922 tax plus interest. Claimant sold sixteen rail passenger cars to the North San Diego County Transit Development Board (NCTD), a public agency which provides bus and rail mass transportation services in the San Diego area. It also sold tooling, equipment and spare parts for the cars. The total charge for the rail cars and other property was $25,798,896. Claimant manufactured the cars and the other items in Canada and delivered them to NCTD in California by common carrier. NCTD paid $l,674,960 in tax to claimant for the rail cars and $130,962 for the spare parts, tooling and equipment, using funds derived from transit taxes or state bonds. Claimant paid the use tax to this Board and has agreed to return the tax to NCTD if it prevails in this claim.

NCTD purchased the cars for use on the ‘‘Coaster’’, a commuter train operating between Oceanside and San Diego. Most of the 43 miles of track and right-of-way on which the Coaster runs are owned by NCTD in conjunction with another local transportation agency. The track, which is part of the interstate rail system extending throughout the United States, is also used by Amtrak rail passenger trains, by Burlington Northern Santa Fe (formerly The Atchison, Topeka & Santa Fe Railway Company) rail freight trains, and by Southern California Regional Rail Authority (SCRRA) rail passenger trains. The Coaster operates primarily on the weekdays during the commuter rush hours, with limited service on Saturdays and none on Sundays. It stops at the same stations as Amtrak, and also at additional stations. Local commuter passengers can ride an Amtrak train or a Coaster train to travel back and forth between the San Diego, Solana Beach, and Oceanside stations. Passengers who are not local commuter passengers can ride the Coaster from one station to another to catch Amtrak train services connecting to an out-of-state destination. It is not possible to make a trip on two carriers on one ticket, since each rail service on the line sells tickets only for its own trains, but NCTD has contracted to have Amtrak operate the Coaster on its behalf.

NCTD purchased the track and right-of-way for the Coaster from Santa Fe in late 1992 or early 1993. In contemplation of this purchase, NCTD filed a ‘‘Verified Notice of Exemption’’ with the Interstate Commerce Commission

BOMBARDIER, INC. (Contd.)

(ICC) in October 1992, together with a Motion to Dismiss that argued that the ICC lacked jurisdiction over the transaction. In its decision dated March 28, 1994 (the ''Orange County'' case), the ICC concluded that NCTD had acquired sufficient rights that Santa Fe's ability to fulfill its common carrier obligation to freight shippers could be impaired. As a result, the ICC asserted jurisdiction over the NCTD's acquisition of the rail assets. NCTD later petitioned the ICC to clarify its decision and to grant a blanket exemption from ICC regulation. On February 28, 1997, the Surface Transportation Board (STB), which had taken over certain of the ICC's functions, granted the blanket exemption. It stated that regulation was not needed to carry out federal transportation policy because NCTD was ''providing no 'service' that we regulate. . . .''

NCTD has provided this Board with letters (the ''STB Letters'') from the Secretary of the STB, stating his informal opinion that NCTD and SCRRA remain ''rail carriers providing transportation subject to the jurisdiction of the Surface Transportation Board (STB),'' notwithstanding their exemption from regulation by the STB. The STB Letters conclude that NCTD and SCRRA are subject to STB jurisdiction, even if not actually regulated by the STB, unless and until the STB decides otherwise in a formal decision.

OPINION

We conclude that the sales and purchases of the rail cars qualify for exemption under Revenue and Taxation Code Section 6352, which allows exemption for tangible personal property that this State is prohibited from taxing under the laws of the United States. Federal law (the ''4-R Act'', 49 U.S.C. § 11501 and former § 11503(b)) prohibits state taxation ''that discriminates against a rail carrier providing transportation subject to the jurisdiction of [the ICC or STB].''

The staff argues that NCTD provides commuter rail transportation entirely within California's borders, asserting that although it operates on track which is part of the interstate rail system, it does not sell tickets for interstate journeys. The staff also asserts that ICC asserted jurisdiction over NCTD's acquisition of the track from Santa Fe solely to prevent NCTD from interfering with Santa Fe's ability to provide interstate rail freight service, that neither the ICC nor the STB has asserted jurisdiction over NCTD's transportation functions, and that the STB recognized this point when it concluded, in the Orange County case, that NCTD is ''providing no 'service' that we regulate.''

The 4-R Act requires only that NCTD be a ''rail carrier'' providing transportation ''subject to the jurisdiction'' of the STB. The ICC and STB have found a broad variety of entanglements with the interstate transportation network to constitute transportation that is subject to their jurisdiction, and the STB has confirmed that NCTD is providing such transportation. Even though the STB has granted NCTD an exemption from regulation, the STB can obviously grant such an ''exemption'' only if the STB has ''jurisdiction'' to regulate in the first place. In the present case, the STB granted an exemption after determining that regulation was not needed with respect to this portion of the interstate rail system; the STB did not determine that it had no jurisdiction to regulate. (*See* 18 Cal. Code of Regs. § 25122 (distinguishing ''exemption'' from tax from

BOMBARDIER, INC. (Contd.)

''jurisdiction'' to tax)). But as a commuter railroad operating on a portion of the interstate rail system, NCTD is entitled to protection from discrimination under the 4-R Act.

The staff argues that California's use tax as applied to NCTD is not discriminatory since some taxpayers who are engaged only in local commerce and who are allegedly similarly situated to NCTD (buses, vans and taxis) are not entitled to any exemptions unavailable to NCTD. Exemptions are allowed for certain watercraft and rail freight cars, but only when they are used in interstate commerce. (Rev. & Tax. Code §§ 6368, 6368.1 and 6368.8.) Thus, according to the staff, there is no discrimination against NCTD. But NCTD points out that all commuter aircraft are exempt, whether or not used in interstate commerce, and California thus discriminates in favor of commuter aircraft and against commuter railroads.

The staff argues that the exemption for aircraft used in common carriage is not sufficient to show discrimination of the type prohibited by the 4-R Act, since states have discretion to levy a tax on railroad property while exempting nonrailroad property. (See *Department of Revenue* v. *AFC Indus., Inc.* (1994) 127 L.Ed.2d 165 (510 U.S. 332); and *Atchison, Topeka and Santa Fe Ry.* v. *State of Ariz.* (9th Cir. 1996) 78 F.3d 438.)

The cases cited by the staff are distinguishable. *Department of Revenue* v. *AFC Indus., Inc.*, supra, involved property taxes, not sales and use taxes. The Court concluded that, because the first three provisions of the 4-R Act provided that the relevant comparison for property taxes was all commercial and industrial taxpayers, consideration of property tax exemptions under the fourth provision of the 4-R Act should use the same comparison class. But the Court did not address what the proper comparison class is for sales and use taxes, and various other courts have held that the proper comparison in connection with non-property taxes is differing modes of transportation. (See *Burlington Northern Railroad Company* v. *Commissioner of Revenue* (Minn. 1993) 509 N.W.2d 551; *Burlington Northern Railroad Company* v. *Triplett* (D. Minn 1988) 682 F.Supp. 443; *Burlington Northern Railroad Company* v. *Huddleston* (10th Cir. l996) 94 F.3d 1413; *Burlington Northern Railroad Company* v. *Bair* (8th Cir. 1995) 60 F.3d 410; *Ogilvie* v. *North Dakota State Board of Equalization* (D.N.D. 1995) 893 F.Supp. 882).

We believe that is the right approach, particularly because that is the approach that was determined to be correct in the case that is closest to the present one: *Nat. R.R. Pass. Corp.* v. *Cal. Bd. of Equalization* (N.D.Cal. 1986) 652 F.Supp. 923 (the ''Amtrak'' case). In *Amtrak*, the court held the Board could not impose use tax on Amtrak's purchase of 15 rail passenger cars, because the tax was ''clearly'' discriminatory where it was not imposed on passenger aircraft and passenger watercraft used by other common carriers. The court held that the 4-R Act did not limit its prohibitions to taxes that discriminate among competitors, but rather among various modes of transportation.

Atchison, Topeka and Santa Fe Ry. v. *State of Ariz.* is also distinguishable. It involved (1) Arizona transaction privilege and use tax, not California sales and use tax, (2) a taxpayer that claimed a complete exemption from the tax for all

BOMBARDIER, INC. (Contd.)

goods and services (not just the means of transportation, as in the present case), and (3) involved a tax structure that, despite an exemption for motor carriers, did not in fact discriminate, since all common carriers (including motor carriers) were subject to one tax or another.

We thus conclude that the subject claims for refund relating to the rail cars should be granted. The claims for refund for the tax paid on the spare parts, tooling, and equipment should be denied.

Done at Sacramento, California, this first day of September, 1999.

Dean F. Andal, Member
Claude Parrish, Member
John Chiang, Member

BORDERS ONLINE, INC.

A retailer selling tangible property online via the Internet is engaged in business in this state and obligated to collect the use tax on its online sales to California customers, if it has an authorized representative in this state for purposes of taking returns of property it sold.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of BORDERS ONLINE, INC.

Appearances:

For Petitioner:	Scott L. Brandman Attorney at Law Douglas D'Agostino Associate Director, Tax
For Sales and Use Tax Department:	David H. Levine Tax Counsel IV
For Appeals Section:	Jeffrey G. Angeja Tax Counsel III

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period April 1, 1998, through September 30, 1999. At the Board hearing, petitioner protested a determination related to petitioner's sales to California purchasers.

Petitioner, an out-of-state corporation, makes online retail sales of tangible personal property (e.g., primarily books, videos, music and gift items) via the Internet. The goods petitioner sells to California purchasers are delivered by common carrier from outside California. Petitioner alleges that it is a separate and distinct legal entity from Borders, Inc. (hereafter Borders), an affiliated corporation that sells similar goods in ''brick-and-mortar'' stores throughout

BORDERS ONLINE, INC. (Contd.)

California. Petitioner further alleges that it did not maintain, occupy or use any place of business in California during the period in question. (See Rev. & Tax. Code, § 6203, subd. (c)(1).)

In a letter dated July 29, 1999, the Sales and Use Tax Department (hereafter the Department) informed petitioner that the Department had concluded that petitioner was a retailer engaged in business in California and was obligated to collect use tax from petitioner's California customers. (See Rev. & Tax. Code, § 6203, subd. (a).) The Department based its conclusion, at least in part, on the significance of a paragraph, which petitioner had posted on petitioner's web site under the heading of "RETURNS." The record of this matter reflects that this paragraph stated, in pertinent part, that:

> "You may return items purchased at borders.com to any Borders Books and Music store within 30 days of the date the item was shipped. All returns must be accompanied by a valid packing slip (your online receipt and shipping notification are not valid substitutes for a packing slip on returns to stores). Gift items may be returned or exchanged if they are accompanied by a valid gift packing slip. You may not return opened music or video items, unless they are defective."

Petitioner alleges that this paragraph first appeared on petitioner's web site some time in June of 1999. Petitioner further alleges that petitioner's internal records reflect that this paragraph was removed from petitioner's web site on or around August 11, 1999. Thus, petitioner apparently removed the paragraph in question shortly after petitioner received notice that the Department considered this paragraph to be evidence that petitioner had a use tax collection obligation under California law. Petitioner has not presented any evidence that would establish that petitioner ever expressly disavowed, either publicly or internally, the policy reflected by the paragraph in question.

Petitioner contends that, notwithstanding the restrictions stated in the posted paragraph, petitioner's customers could return merchandise at a Borders store without a valid packing slip and receive a store credit. Additionally, petitioner admits that, throughout the period in question, petitioner's California customers could obtain cash refunds by returning merchandise purchased from petitioner, together with a valid packing slip, to a Borders store. In other words, petitioner's customers' ability to obtain such cash refunds from Borders was not dependent on whether the paragraph at issue was posted on petitioner's web site. According to petitioner, Borders also provided return services to individuals who had purchased merchandise from one of Borders's or petitioner's competitors; however, Borders did not, and would not, provide cash refunds to customers of Borders's or petitioner's competitors.

Petitioner alleges that any merchandise petitioner's customers returned to Borders was not sent back to petitioner but, instead, was added to Borders's inventory. Petitioner claims that Borders did not charge petitioner for return and exchange services. Finally, petitioner further claims that Borders absorbed any losses associated with accepting returns of defective merchandise from petitioner's customers.

BORDERS ONLINE, INC. (Contd.)

OPINION

With certain exceptions that are not relevant to this matter, Revenue and Taxation Code section (hereafter Section) 6203 imposes a use tax collection obligation on ''. . . every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state. . . .'' Under subdivision (c)(2) of Section 6203, the meaning of ''retailer engaged in business in this state'' includes:

> ''[a]ny retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.''

When, as here, no dispute exists with respect to an out-of-state seller's status as a retailer, three additional requirements must be satisfied for the seller to be a ''retailer engaged in business in this state'' under Section 6203, subdivision (c)(2).

First, the out-of-state retailer must have a representative, agent, salesperson, canvasser, independent contractor or solicitor (hereafter, collectively, representative). Second, this representative must be operating in California under the authority of the out-of-state retailer or its subsidiary (i.e., the in-state representative must be authorized to act on the out-of-state retailer's behalf). Third, the out-of-state retailer's authorized representative's operations in California must include one of the following activities: selling, delivering, installing, assembling or taking orders for tangible personal property. Applying this analysis to the instant matter, these three requirements are met if: (1) Borders was petitioner's authorized representative in this state for purposes of taking returns from petitioner's California customers; and (2) the taking of such returns constitutes ''selling.'' [1] The first issue is a matter of fact, the second is a matter of law.

As to the first issue, the greater weight of the available evidence establishes that, for the period in question, Borders was petitioner's authorized representative in this state for the purpose of accepting returns from petitioner's California customers. As indicated above, petitioner expressly stated on its web site that Borders was petitioner's authorized representative for this purpose. Petitioner has submitted no evidence showing that Borders ever objected to being designated as petitioner's authorized representative or that petitioner ever revoked this designation. Rather, the evidence shows that petitioner removed the web site declaration of this designation in response to the Department's July 29, 1999, letter, not because Borders's status as petitioner's authorized representative had changed.

Although petitioner's express web site declaration is sufficient to establish that Borders was petitioner's authorized representative for returns, in addition to this

[1] The Department has not alleged that Borders, during the period at issue, engaged in any activities on petitioner's behalf in California that would constitute ''delivering, installing, assembling, or the taking of orders for any tangible personal property'' as these terms are used under subdivision (c)(2) of Section 6203.

BORDERS ONLINE, INC. (Contd.)

direct evidence, circumstantial evidence sufficient to establish this fact also exists. Specifically, by petitioner's own admission, Borders provided unique and preferential return services to petitioner's customers. As discussed above, Borders purportedly would allow anyone to exchange for store credit any merchandise Borders stocked, regardless of whether that merchandise was purchased from Borders or petitioner or from one of their competitors. Such exchange transactions presumably would result in little, if any, net loss for Borders and would promote good will. However, even if petitioner were to establish, which petitioner has not, that Borders's practice of accepting returns from petitioner's customers was wholly independent of petitioner's published return policy, Borders's willingness to provide cash refunds to petitioner's customers, when Borders refused to do this for customers of Borders's or petitioner's competitors, indicates that Borders made such refunds because Borders was petitioner's authorized representative. While not exhaustive of the circumstantial evidence indicating that Borders was petitioner's authorized representative for returns in California, Borders's preferential treatment of petitioner's customers suffices to establish this fact.

As to the legal issue that remains, we conclude that, when accomplished through an authorized representative, the taking of returns constitutes ''selling'' under subdivision (c)(2) of Section 6203. Because neither the Sales and Use Tax Law in general, nor Section 6203 in specific, contains a definition of ''selling,'' following the accepted canons of statutory construction, we construe this term according to its common usage. In other words, ''selling'' is inclusive of all activities that are an integral part of making sales.

When out-of-state retailers that make offers of sale to potential customers in California authorize in-state representatives to take returns, these retailers acknowledge that the taking of returns is an integral part of their selling efforts. Such an acknowledgement comports with common sense because the provision of convenient and trustworthy return procedures can be crucial to an out-of-state retailer's ability to make sales. This is especially evident in the realm of e-commerce.

For example, in this case, petitioner identified Borders as petitioner's authorized in-state representative for effecting the generous, convenient return policy petitioner published on its web site. It is apparent that petitioner announced this favorable return policy to induce potential customers, who might otherwise be wary of making purchases from a remote seller, to place orders. Indeed, many potential online customers would not place an order with an online retailer whose return policy was not worthy of confidence. An online retailer's ability to offer these potential customers convenient returns and exchanges at nearby reputable ''brick-and-mortar'' stores, as petitioner did, would assuredly help promote such confidence. Moreover, some online purchasers will not be satisfied with their purchases. An online retailer that offers convenient, local return and exchange options is much more likely to obtain repeat business from such purchasers. The important role that an online retailer's return policy plays in obtaining repeat business further underscores how integral the taking of returns is to selling in e-commerce transactions.

BORDERS ONLINE, INC. (Contd.)

In *Quill Corp.* v. *North Dakota* (1992) 504 U.S. 298 [hereafter *Quill*], the United States Supreme Court held that, pursuant to the Commerce Clause of the United States Constitution, a state cannot impose a use tax collection obligation on out-of-state retailers unless those retailers have ''substantial nexus'' with that state. The *Quill* court explained that, to establish commerce-clause nexus, a state must show that the out-of-state retailer, or a representative of the out-of-state retailer, has a sufficiently substantial physical presence in the state to justify the imposition of a use tax collection obligation. (*Ibid.*) In this case, petitioner had a substantial physical presence in California through the many places of business and employees of Borders, petitioner's authorized representative in this state for the purpose of selling tangible personal property. Petitioner's substantial physical presence in this state more than suffices to establish that petitioner had commerce-clause nexus with California during the period in question. (See *ibid.*)

In sum, both the direct and circumstantial evidence are sufficient to establish that Borders, acting as petitioner's authorized representative, performed return and exchange activities in California. Such activities, when performed through an authorized representative, are an integral part of selling tangible personal property. Thus, due to Borders's actions in California on petitioner's behalf, petitioner was a ''retailer engaged in business in this state'' during the period in question. Accordingly, the petition should be denied as to these issues because petitioner was obligated to collect, and remit, use tax from petitioner's California customers. (Rev. & Tax. Code, §§ 6203, subds. (a) & (c)(2), 6204.)

Adopted at Sacramento, California, on September 26, 2001.

Claude Parrish, Chairman

John Chiang, Member

Johan Klehs, Member

Dean Andal, Member

Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

ANTHONY J. CARSELLO

Artistic expressions in the form of paintings, photographs, sculpture and designs are tangible personal property and the sale of such items do not represent the sale of services but rather the taxable sale of tangible personal property.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination of ANTHONY J. CARSELLO

Appearances:

For petitioner: Mr. Earl Schuller
Attorney at Law

ANTHONY J. CARSELLO (Contd.)

For Staff: Mr. T. P. Putnam
Mr. John H. Knowles
Tax Counsels

MEMORANDUM OPINION

A petition has been filed by Anthony J. Carsello for redetermination of sales taxes for the period February 1, 1963, to March 31, 1965, in the amount of $2,414.64, plus a penalty of $241.46 for failure to file returns.

The taxpayer is an industrial designer. Companies engaged in the manufacture of consumer goods wish to make their products look as if they can perform their intended function better than competitive products. Such products are said to have ''shelf appeal''. The taxpayer is retained by companies of this type to aid in the external design of a product. During the time in question, the taxpayer participated in the design of such items as a chain saw, an electric razor, an outboard motor, a camera, and drawer pulls.

The taxpayer is basically an artist by training; although he has had some engineering background. The engineering of the product is generally completed before the taxpayer is called in. The taxpayer in most instances works with the research and development department of the manufacturer, which supplies him with the engineering data and an explanation of the product's intended use. The taxpayer, when agreeing to a job, gives an estimate of his charges. The taxpayer will then bill his clients monthly for work performed on the contract during that month. It may be necessary for the taxpayer to contact or consult with the client several times as the design progresses.

In each instance, the manufacturer wants some representation of the final design to be prepared by the taxpayer. During the course of the design, the taxpayer may prepare sketches of his ideas, but he is working towards producing a final representation which could take the form of a two or three dimensional drawing, a clay model, a mock-up, or a working model.

The taxpayer was audited for the period February 1, 1963, to March 31, 1965. Amounts billed clients that were not clearly labeled as arising from nontaxable services were scheduled as taxable gross receipts. Upon the recommendation of the hearing officer following a preliminary hearing, the taxpayer was contacted in order that an adjustment might be made in the audit figures for any commissions or fees relating to services not connected with sales of tangible personal property. The taxpayer through his attorney stated that he could not produce any figures to support an adjustment for such commissions or fees.

We have previously adopted a comprehensive, administrative ruling dealing with the subject of ''Advertising Agencies, Commercial Artists and Designers''. It is designated as ruling No. 2 (Cal. Adm. Code, Title 18, section 1902) and provided at all times material to the present matter as follows:

''(a) Nontaxable Services

''Tax does not apply to charges by advertising agencies, commercial artists or designers for services rendered that do not represent services that are a part of a sale of tangible personal property, or a labor or service cost in the

production of tangible personal property. Examples of such nontaxable services are: writing original manuscripts and news releases; writing copy for use in newspapers, magazines, or other advertising, or to be broadcast on television or radio; compiling statistical and other information; placing and/or arranging for the placing of advertising in media, such as newspapers, magazines, or other publications; billboards and other forms of outdoor advertising, cards in cars, busses and other facilities used in public transportation; and delivering or causing the delivery of brochures, pamphlets, cards, etc. Charges for such items as supervision, consultation, research, postage, express, telephone and telegraph messages, transportation and travel expense, if involved in the rendering of such services, are likewise not taxable.

"(b) Agency Fee or Commission

"When an amount billed as an agency 'fee,' 'service charge', or 'commission' represents a charge or part of the charge for any of the nontaxable services described under paragraph (a) above, the amount so billed is not taxable. Such a charge by a recognized advertising agency will be considered to be made for nontaxable services.

"(c) Items Taxable

"The tax applies to the entire amount charged to clients for items of tangible personal property such as drawings, paintings, designs, photographs, lettering, assemblies and printed matter. Whether the items of property are used for reproduction or display purposes is immaterial.

"(d) Preliminary Art

" 'Preliminary art' as used herein means roughs, visualizations, comprehensives and layouts prepared for acceptance by clients before a contract is entered into or approval is given for finished art. ('Finished art' as used herein means the final art used for actual reproduction by photomechanical or other processes.) Tax does not apply to separate charges for preliminary art except where the preliminary art becomes physically incorporated into the finished art, as, for example, when the finished art is made by inking directly over a pencil sketch or drawing, or the approved layout is used as camera copy for reproduction.

"The charge for preliminary art must be billed separately to the client, either on a separate billing or separately charged for on the billing for the finished art. It must be clearly identified on the billing as preliminary art, of one or more of the types mentioned in the preceding paragraph. Proof of ordering or producing the preliminary art prior to date of contract or approval for finished art, shall be evidenced by purchase orders of the buyer, or by work orders or other records of the seller. No other proof shall be required.

"(e) Retouching

"Retouching ordinarily constitutes a step in the process of preparing photographs or other art work for reproduction, and is done to improve the quality of the reproductions. Tax applies to charges for photo retouching unless it can be clearly demonstrated that the retouching is done only for the purpose of repairing or restoring a photograph to its original condition.

ANTHONY J. CARSELLO (Contd.)

''(f) Items Purchased by Agency, Artist or Designer

''An advertising agency, artist, or designer is the consumer of tangible personal property used in the operation of its business, such as stationery, ink, paint, tools, drawing tables, T-squares, pens, pencils, and other office supplies. Tax applies to the sale of such property to the agency, artist, or designer.

''The agency, artist, or designer is the seller of, and may purchase for resale, any item that he resells before use, or that becomes physically an ingredient or component part of tangible personal property sold by him, as, for example, illustration board, paint, ink, rubber cement, flap paper, wrapping paper, photographs, photostats, or art purchased from other artists.''

The ruling is determinative of the question presented. Designers are subject to tax on finished art sold to their clients. While preliminary art is not taxable, it must be separately stated on the invoice, a practice not followed by the taxpayer during the audit period. Similarly, the taxpayer has been unable to substantiate any portion of his charges as being attributable to services that are not a part of a sale of tangible personal property. The burden of proof of such a matter is on the taxpayer.

The taxpayer contends that ruling 2 is inapplicable and that he is selling ideas which he conveys by use of a model rather than selling an end item of tangible personal property. As respects the application of ruling 2 to the taxpayer's situation, we note that this ruling purports to cover ''designers'' generally. The ruling is directed as well at commercial artists and advertising agencies producing art work. The taxpayer is retained principally for artistic reasons. Thus, the taxpayer is engaged in an activity which falls within ruling 2 both because he must be classified as a designer and on the principle that the taxpayer is performing in an area similar to others falling within the ruling's provisions.

The question of whether the taxpayer is really selling ideas and uses the models to convey them involves us in one of the most difficult areas in the administration of the sales tax. This board has not recognized transfers of tangible personal property to be taxable sales when the transfer is the means of conveying ideas. Thus, the transfer of a lawyer's brief, a writer's manuscript, and an architect's blueprint are not subject to the tax. Artists, however, have never come within this rule. Artistic expressions in the form of paintings, photographs, sculpture, etc. are taxable when sold. The distinction is not between service industries on the one hand and manufacturers on the other. As pointed out in *People* v. *Grazer* (1956) 138 Cal.App.2d 274 [291 P.2d 957]:

> ''The expense of the producer of pictures is almost entirely the cost of the skilled services of the radiologist and the technicians and the use of equipment which is generally quite costly. But the price charged for all taxable transfers is one more often than not largely a charge for services rendered in connection with the tangible object transferred.'' 138 Cal.App.2d at 278.

Rather the distinction is between whether the client or customer in the final analysis desires the idea or the tangible object.

ANTHONY J. CARSELLO (Contd.)

In *Albers* v. *State Board of Equalization* (1965) 237 Cal.App.2d 494 [47 Cal.Rptr. 69], the court found a draftsman who produced mechanical drawings in which he did not incorporate any of his own ideas, concepts, designs or specifications subject to tax on his sales. The court held that in such a case the customer was purchasing the detailed drawing. We believe the proper construction of this case and the test of whether an item is taxable is whether an end item of tangible property is called for in the contract.

Ruling 2 must be construed as an administrative determination that final art is such an end item. As applied to the facts of this case, there is support for the position that the customer was principally interested in the drawing or model. The end item was always called for by the contract, and title to it passed to the customer. After delivery the taxpayer's job was finished, but the drawing or model was used by the manufacturer to aid in the decision to go ahead with the project and to form the artistic basis for prototypes and production models.

The petition for redetermination is denied.

Done at Sacramento, California, this 25th day of February, 1969.

John W. Lynch, Chairman

George R. Reilly, Member

Paul R. Leake, Member

Richard Nevins, Member

Attested by: H. F. Freeman, Executive Secretary

CHALLENGE EQUIPMENT CORPORATION

A mail handling, sorting and conveyor system designed for and installed in a post office constitutes a fixture, not machinery and equipment. The system is firmly attached to the building by a method of bolting that includes firing studs into a concrete floor. If the system were removed, the studs would still remain and before the floor could be used for other purposes the studs would have to be cut off or otherwise removed and the holes filled in. It is also concluded that the system is not one that could be readily removed as a unit. The fact that the system includes moving parts and performs a mechanical mail handling function does not, in and of itself, dictate the conclusion that it is "machinery and equipment".

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of CHALLENGE EQUIPMENT CORPORATION *for Redetermination of Liability Determined under the Sales and Use Tax Law*

CHALLENGE EQUIPMENT CORPORATION (Contd.)

Appearances:

For Petitioner: Mr. Neil D. Chaitin
President
Challenge Equipment Corporation
Mr. Robert Kinser
Industrial Engineer (Witness)
San Francisco District,
U.S. Postal Service

For Staff: Mr. Robert H. Anderson
Tax Counsel

MEMORANDUM OPINION

This petition was filed to protest the assertion of use tax on the Petitioner's cost of a mail handling, sorting and conveyor system, hereinafter ''system'', which was designed for, and installed in Building 415, Cheli Terminal, Los Angeles Post Office, under a contract with the United States Government.

The issue presented by the petition is whether the system is a ''fixture'' or ''machinery and equipment'' within the meaning of the two terms as used in regulation 1615, formerly ruling 12 (18 Cal. Admin. Code, § 1615).

Petitioner, Challenge Equipment Corporation, is a corporation that engages in the sale and installation of industrial equipment. Some of Petitioner's construction contracts are with private industry entities while others are with instrumentalities of the United States Government.

This controversy arises as a result of a contract to furnish and install a system to be used for handling, sorting and conveying mail from the outside to within, within, and from within to the outside of a building that was to be used as a United States Post Office facility.

Mr. Robert W. Kinser, Director, Industrial Engineering Division, United States Postal Service supervised the design and planning of the system which was designed especially for the building in which it was installed.

Counsel for the Staff contended the system is a fixture under regulation 1615, United States Contractors. Mr. Chaitin contends the system constitutes machinery and equipment under regulation 1615. If it is a fixture, the Petitioner is the consumer thereof under the government contract and the use tax applies to the cost of it to Petitioner. On the other hand, if it is machinery and equipment, the Petitioner is the retailer thereof and the sale would be an exempt retail sale to the United States Government.

The system consists of numerous conveyors, rollers, belts, ladders, work platforms, etc., that are connected and affixed to the floor of the building or to the roof trusses so that they will not move or shift when in use. The conveyor portions of the system vary in length from as short as eight feet to as long as 210 feet and are installed horizontally at varied heights off of the floor and at varied angles so as to achieve the lifting of mail as high as nine to 10 feet off of the floor level.

CHALLENGE EQUIPMENT CORPORATION (Contd.)

The units were manufactured in varied lengths, generally about 10 feet. Some were constructed at angles to achieve turns around corners, etc.

A general description of the type of units making up the system is listed on the blue print drawing of the system and includes such things as:

1. Conveyor, roller bed/return, 22 inches high, 42 inches wide and 72 feet long.

2. Conveyor, roller bed/return, 42 inches wide, and 210 feet long, that starts at a height of one foot off the floor, rises to a height of 10 feet and descends to another area and to a height of 30 inches off the floor.

3. Conveyor, roller bed/return, 30 inches to nine and one-half feet high, 42 inches wide and 200 feet long.

4. Work platforms, elevated with ladder and guard rails which make up part of the conveyor support.

5. Gravity conveyor rollers in 10 and 12 foot sections, linked together to move mail over distances of up to 100 feet.

In all there was over 1,700 feet of belts, rollers, etc., varying in width from 30 to 42 inches wide and from one foot to 10 feet off the floor. They were integrated and connected in various ways and were affixed to the floor by studs driven (fired) into the floor and to roof trusses by bolts. Some belts were powered by motors, while mail moved along others by gravity.

Section 6384 of the Revenue and Taxation Code provides:

> Notwithstanding any other provision of the law the tax imposed under this part shall apply to the gross receipts from the sale of any tangible personal property to contractors purchasing such property either as the agents of the United States or for their own account and subsequent resale to the United States for the construction of improvements on or to real property in this State.

Regulation 1615 (18 Cal. Admin. Code, § 1615) was adopted under the authority given the board of equalization by the Legislature under section 7051 of the Revenue and Taxation Code. Section 7051 reads:

> The board shall enforce the provisions of this part and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part. The board may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect.

Regulation 1615 relates to United States Contractors and is applicable to Petitioner's case. It provides in part as follows:

> Either the sales tax or the use tax applies with respect to sales of tangible personal property (including materials, fixtures, supplies, and equipment) to contractors or subcontractors for use in the performance of contracts with the United States for the construction of improvements on or to real property in this State.

* * *

CHALLENGE EQUIPMENT CORPORATION (Contd.)

Tax does not apply to sales of ''machinery and equipment'' to contractors or subcontractors. As used herein, the term ''machinery and equipment'' means property to which each of the following conditions applies:

1. It is not used by the contractor in making the improvements. . . .

2. It either is not attached to the realty or, if attached, is readily removable as a unit (as distinguished from ''fixtures''). . . .

3. It is installed for the purpose of performing a manufacturing operation or some other function not essential to the structure itself.

4. Title to the property passes to the United States before the contractor makes any use of it.

* * *

''Fixtures'' as distinguished from ''machinery and equipment'' are things which are necessary to a structure and so firmly attached to the realty as to constitute a part of the structure. They are essential to the use of the building or other structure, and include such things as:

* * *

Elevators, hoists and conveying units

* * *

There is no doubt about the fact that the system is a large and complex conveying unit. It is essential to the use of the building as a post office mail handling facility even though, if the system were completely dismantled and moved out of the building, the building would still stand and could be used for general storage of property. The system is firmly attached to the building by a method of bolting that includes firing studs into the concrete floor. If the system were removed, the studs would still remain and before the floor could be used for other purposes the studs would have to be cut off or otherwise removed and the holes filled in. It is also concluded that the system is not one that could be readily removed as a unit. The fact that the system includes moving parts and performs a mechanical mail handling function does not, in and of itself, dictate the conclusion that it is ''machinery and equipment'' within the meaning of the term as used in regulation 1615.

Considering all of the facts, it is our view the system is a ''fixture'' and under regulation 1615 Petitioner is the consumer and not the retailer thereof. Accordingly, a redetermination is ordered without any adjustment to the item representing tax on the cost of the fixture.

Done at Sacramento, California, this 25th day of October, 1972.

John W. Lynch, Chairman
Richard Nevins, Member
William M. Bennett, Member
George R. Reilly, Member
Attested by: W. W. Dunlop, Executive Secretary

CONTINENTAL TRAILWAYS, INC.

While tax does not apply to sales or leases between divisions of a corporation, it may apply to sales or leases between corporations which are components of a multi-corporate structure. Transfers between parent and subsidiary corporations, for example, have customarily been regarded as transfers between "persons" and subject to tax without regard to the business relationship.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petitions of CONTINENTAL TRAILWAYS, INC., dba CONTINENTAL WESTERN LINES DIV., AMERICAN BUSLINES, INC., TRANSCONTINENTAL BUS SYSTEM, INC., CONTINENTAL SOUTHERN LINES, INC., ARKANSAS MOTOR COACH LTD., INC., CONTINENTAL BUS SYSTEMS, INC., CONTINENTAL CRESCENT LINES, INC., CONTINENTAL PANHANDLE LINES, INC., CONTINENTAL TENNESSEE LINES, INC., DENVER-COLORADO SPRINGS-PUEBLO MOTOR WAY, INC., DENVER-SALT LAKE-PACIFIC STAGES, INC., EDWARDS MOTOR TRANSIT CO., MIDWEST BUSLINES, INC., QUEEN CITY COACH CO., SAFEWAY TRAILS, INC., SMOKY MOUNTAIN STAGES, INC., and UNION BUS LINES, INC.

Appearances:

For Petitioners: Mr. Robert W. Hancock
Attorney at Law

For Staff: Mr. J. Kenneth McManigal
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of seventeen petitions for redetermination of sales taxes and penalties determined against petitioners for the period August 1, 1965 to December 31, 1969.

Petitioners are affiliated corporations collectively doing business as "Continental Trailways". Continental Trailways, Inc., is both an operating company, dba Continental Western American Buslines, Inc., Transcontinental Bus Systems, Inc., Continental Southern Lines, Inc., Arkansas Motor Coach Ltd., Inc., Continental Tennessee Lines, Inc., Denver-Colorado Springs-Pueblo Motor Way, Inc., Denver-Salt Lake-Pacific Stages, Inc., Midwest Buslines, Inc., Queen City Coach Co., Safeway Trails, Inc., Smoky Mountain Stages, Inc., and Union Bus Lines, Inc. Continental Panhandle Lines, Inc., is 50 percent owned by Continental Trailways, Inc. Edwards Motor Transit Co., is owned by TCO Industries, a holding company and the parent corporation of Continental Trailways, Inc.

Being affiliated corporations, petitioners can offer through service without changes of buses to persons traveling from coast to coast and, as a result of membership in the National Trailways Association, they can offer such through service to numerous locations. That service is effected by means of pooling arrangements whereby companies whose routes are traversed provide the buses required, each company providing a portion of the buses required to execute the

CONTINENTAL TRAILWAYS, INC. (Contd.)

schedule as determined through the use of a ratio derived from the mileage of its portion of the route and the mileage of the entire route. For example, if through service were to be provided between Los Angeles and New York, and if the mileage of Continental Trailways, Inc.'s, route constituted 10 percent of the mileage of the entire route, Continental Trailways, Inc., would provide 10 percent of the buses required to execute the schedule for that route. As a result, petitioners are able to compete with Greyhound Lines for the carriage of such persons.

Buses of one company operated over the routes of other companies are leased to the latter, and each company is responsible for the expenses of leased buses traversing its routes. During the period August 1, 1965 to December 31, 1969, the amount attributed to such expenses was 15 cents per mile. As each petitioner was regarded as a person for purposes of the Sales and Use Tax Law, and as petitioners did not report or pay taxes measured by lease receipts derived from California, amounts equal to the amounts of such receipts were established as the taxable measures. In addition, 10 percent penalties were imposed in those instances in which petitioners failed to file sales and use tax returns.

In enacting Section 6005 of the Revenue and Taxation Code, the Legislature defined ''person'' as any individual, firm, copartnership, joint venture, association, social club, fraternal organization, corporation, estate, trust, business trust, receiver, assignee for the benefit of creditors, trustee, trustee in bankruptcy, syndicate, the United States, this State, any county, city and county, municipality, district, or other political subdivision of the State, or any other group or combination acting as a unit. Petitioners have asserted that they operate as a single unit and that together they constitute a group or combination acting as a unit and hence, a person, with the result that they are not required to report or pay those taxes.

In administering and enforcing that portion of Section 6005 which defines ''person'' as ''any corporation'', we have distinguished between corporations utilizing divisional structures, regarding each such corporation as a person, and corporations utilizing multi-corporate structures, regarding each corporation within such a structure as a person. Thus, while tax does not apply to sales or leases between divisions of a corporation, it may apply to sales or leases between corporations which are components of a multi-corporate structure. Transfers between parent and subsidiary corporations, for example, have customarily been treated as transfers between ''persons'' and subject to tax without regard to the business relationship (see Cal. Tax Service Annotations 395.1520, 1/11/55; 395.2500, 9/17/64; 395.2540, 6/29/54).

Rarely have we applied that portion of Section 6005 which defines ''person'' as ''any other group or combination acting as a unit''. Unrelated oil companies which became co-owners of a petroleum gas processing plant and operated it jointly have been regarded as a ''group or combination acting as a unit'', with the result that processing charges made to individual members were taxable (Cal. Tax Service Annotation 415.0080, 3/4/68). That enterprise had all of the elements of a partnership except that it was conducted to reduce costs rather than to obtain ''profit'' in the ordinary sense. The situation is distinguishable on its facts from

CONTINENTAL TRAILWAYS, INC. (Contd.)

the case before us and, in any event, does not constitute precedent for disregarding transfers between individual members.

While petitioners' presentation was directed to the establishment of the proposition that they operate as a single unit and that together they constitute a group or combination acting as a unit and hence, a person for purposes of Section 6005, analysis of petitioners' structure and operations discloses that each petitioner is a person for purposes thereof. That American Buslines, Inc., and Transcontinental Bus System, Inc., applied for and were issued seller's permits individually in their own names in the 1950's suggests that they also have regarded themselves as persons.

As petitioners could have utilized a divisional structure but did not do so because benefits derived from their use of a multi-corporate structure exceeded those which they might otherwise have derived, they must assume any burdens incurred as the result of that business decision. Such burdens include any obligations and liabilities arising under the California Sales and Use Tax Law and, in this instance, include those of reporting and paying taxes upon lease receipts derived from California.

Petitioners have raised a number of additional issues which they wish to preserve but have not seriously pressed in this proceeding. Without enumerating or discussing their contentions in detail, suffice it to say that we have found no merit in them.

Accordingly, the taxes as determined shall be redetermined without change.

With respect to the penalties imposed, as relief therefrom was requested in accordance with Section 6592 of the Revenue and Taxation Code, and as it was concluded that petitioners should be relieved of such penalties, the penalties imposed shall be canceled.

Done at Sacramento, California, this 7th day of February, 1973.

William M. Bennett, Chairman
George R. Reilly, Member
John W. Lynch, Member
Richard Nevins, Member

Attested by: William W. Dunlop, Executive Secretary

CUSHION CUT, INC.

As diamond saw blades are not materials or fixtures, the exemption from tax rate increases for materials and fixtures furnished under fixed price construction contracts was not available with respect to sales of such saw blades to contractors.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of CUSHION CUT, INC.

CUSHION CUT, INC. (Contd.)

Appearances:
For Petitioner: Mr. Lester Kuzmick
President
For Staff: Mr. J. Kenneth McManigal
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merit of a petition for redetermination of a portion of tax in the amount of $1,297.30, plus statutory interest determined against petitioner for the period October 1, 1966 to September 30, 1969.

Petitioner is a manufacturer of saws and diamond saw blades. During the audit period, it sold diamond saw blades to a construction contractor for use in performing engineering construction project contracts. In so doing, petitioner would submit to the contractor a bid based upon a specific cutting cost per foot for the job for which the contractor wished to bid. The contractor then used this cost in submitting his bid for that job, and when it was the successful bidder, the diamond saw blades were delivered to it, were stored at the jobsite, and were used as needed. The contractor forwarded a detailed report on each job indicating the actual amount of feet cut and petitioner invoiced accordingly. Portions of diamond saw blades not consumed on jobs were returned to petitioner's stock and were used on subsequent jobs.

Effective August 1, 1967, Revenue and Taxation Code Section 6376 exempted from 25 percent of the sales tax the gross receipts from the sale of material and fixtures, if the sales of the material and fixtures were obligated pursuant to an engineering construction project contract entered into for a fixed price prior to that date. Petitioner regarded its sales of diamond saw blades to the contractor as sales of material, the gross receipts from which were exempt from 25 percent of the sales tax under Section 6376, and petitioner asserted that on and after August 1, 1967, it should have only reported and paid State sales tax at the rate of 3 percent rather than at the rate of 4 percent of its gross receipts from such sales. It is 25 percent of the sales tax, 1 percent of the State sales tax rate, applied to petitioner's gross receipts from its sales of diamond saw blades to the contractor on and after August 1, 1967, sales tax in the amount of $177.71, which petitioner protests.

In enacting Section 6376, the Legislature did not define the terms ''material'' and ''fixtures''. Thus, it was determined that the definitions of those terms as set forth in Sales and Use Tax Ruling 11 would be used to define ''material'' and ''fixtures'' for purposes of Section 6376. Business Taxes General Bulletin 67-12, Part 3, so provided:

> ''c. 'Materials' and 'fixtures' as used herein have the meanings ascribed thereto in sales and use tax rulings 11 and 12.''

CUSHION CUT, INC. (Contd.)

In this regard, Ruling 11(a) provided:

"(3) The term 'materials' as used herein means tangible personal property which when combined with other tangible personal property loses its identity to become an integral and inseparable part of the completed structure.

"(4) The term 'fixtures' as used herein means things which are accessory to a building and which do not lose their identity as accessories when placed or installed."

Ruling 12, Part 4, provided, in part:

" 'Fixtures' . . . are things which are necessary to a structure and so firmly attached to the realty as to constitute a part of the structure. They are essential to the use of the building or other structure. . . ."

We have construed the exemption provided by Section 6376 as being available only in cases where tangible personal property sold constitutes material or fixtures per Bulletin 67-12. For example, we have done so in the petition matters of Western Contracting Corporation, which has filed actions in Los Angeles Superior Court challenging this construction as to the availability of the exemption.

In our view, the diamond saw blades were not material or fixtures per Bulletin 67-12. While some bits and pieces from used diamond saw blades no doubt settled in highway roadbeds, this was not a combining of the diamond saw blades with other tangible personal property to become an integral and inseparable part of a completed structure, the meaning ascribed to "material" therein. In addition, the Office of the Attorney General advised on December 7, 1967 that tools purchased and consumed in the performance of contracts referenced in Section 6376 did not qualify for the exemption provided therein.

Consistent with the interpretation of Section 6376 as set forth in Bulletin 67-12 and consistent with our position in the Western Contracting Corporation actions now pending, we have concluded that as diamond saw blades are not material or fixtures as defined in Bulletin 67-12, the exemption provided by Section 6376 was not available in the case of petitioner's sales thereof to the contractor, and the applicable State sales tax rate to those sales made on and after August 1, 1967 was the 4 percent rate. Accordingly, the tax as determined shall be redetermined without adjustment.

Done at Sacramento, California, this 14th day of September, 1971.

Richard Nevins, Chairman

John W. Lynch, Member

George R. Reilly, Member

William M. Bennett, Member

Attested by: H. F. Freeman, Executive Secretary

ERIC ECKSTEIN

Preparing drawings from an established reference material provided by the customer does not involve the creation of original concepts or ideas. Thus, the transfer of drawings is considered the true object of the contract and subject to tax.

Where the taxpayer has complete responsibility for the design, shape, size, and material specification for the proposed product, the preparation and transfer of the original drawing is exempt from tax as the true object of the contract is the purchase of original concept or ideas.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of ERIC ECKSTEIN dba EMPIRE ENGINEERING

Appearances:

For Petitioner:	Mr. Eric Eckstein In Pro. Per.
For Staff:	Mr. W. E. Burkett Tax Counsel

MEMORANDUM OPINION

A petition has been filed by Mr. Eric Eckstein for a redetermination of the tax deficiency determination issued for additional sales and use taxes for the period April 1, 1963, to March 31, 1966, in the amount of $1,017.16, plus statutory interest.

The petitioner is the sole proprietor of a firm engaged in producing drawings for customers. The production of the drawings is carried out by employees with varying degrees of drafting and engineering skills. The petitioner is a registered engineer.

The protested measure of tax of $24,455 consists of the labor portion of time and material billings to customers for the preparation of certain types of drawings. The work performed by petitioner's firm is in three separate categories which have been described as follows:

1. The firm redraws a completed drawing provided by the customer on a new permanent type of paper. The drawing is prepared for the purpose of reproducing other drawings, for making microreproduced copies or for other purposes. Technical information obtained from independent reference material may be added to the drawing prepared by the firm.

2. Working from a design drawing provided by the customer, the firm produces a high quality manufacturing drawing for use in manufacturing a product. The drawing may represent a topical view, side view, or only a designated portion of the original design drawing. Again, technical information obtained from military manuals or other defense material may be catalogued on the face of the drawing.

3. A third type of work described by petitioner at the oral hearing consists of the preparation of an original drawing of a proposed product or component part of a product. The firm is said to have complete responsibility for the

ERIC ECKSTEIN (Contd.)

design; including the shape, size, and materiel specifications for the product. Petitioner has not complied with the staff's request for exhibits and audit information for transactions claimed to be in this category.

It is petitioner's contention that the charges were for the performance of exempt services, or in the alternate that the property was purchased by the customers for purposes of resale. This alternate basis for exemption must be denied in view of the absence of evidence that the purchases were made by the customer for purposes of resale. Petitioner has not presented resale certificates to overcome the presumption that the transactions were retail sales (Rev. & Tax. Code § 6091; sales and use taxes ruling 68).

In determining the classification of these labor charges, the essential question is whether the customer desired to acquire the service labor per se or the tangible property produced by the service labor for his use. (*People* v. *Grazer* (1956) 138 Cal.App.2d 274; *Albers* v. *State Board of Equalization* (1965) 237 Cal.App.2d 494.) If the customer merely sought to obtain the intangible concepts or ideas which flowed from the performance of the service labor (true object of the contract) then the transaction would qualify as an exempt sale of services. This would follow even though tangible personal property was incidentally used to convey the intangible concepts or ideas to the customer. (Sales and use taxes ruling 1.) However, if the object of the contract was to secure the production of a drawing from detail supplied by the customer, the transaction constitutes a sale of tangible personal property under the provisions of section 6006(f) of the code which defines a sale to include:

''A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, or of any publication.''

Based upon the evidence before us, we conclude that the activities performed by petitioner in the first and second category described above are properly classified as sales of tangible personal property under the aforementioned provisions of section 6006(f) of the code. In preparing these drawings, the petitioner worked from an established reference material to produce drawings acquired for use by the customer. While the work performed by petitioner's employees undoubtedly required considerable skill, it did not involve the creation of original concepts or ideas. Since the contracts were for the production of detailed drawings and not original concepts or ideas, the finished article, the drawing, is considered to be the true object of the contract.

The labor charges attributable to the addition of the technical information are includible in the measure of the tax as services performed as part of the sale (Rev. & Tax. Code § 6012(a)).

Any transactions in the third category described above would be properly classified as a sale of exempt services because the true object of the contract was the purchase of original concepts or ideas for a newly created product or component thereof. The record does not contain any evidence from which a determination can be made of the amount of such items included in the protested measure of tax. Although petitioner has been requested to provide this

ERIC ECKSTEIN (Contd.)

information, we take note of the fact that he has not done so. Therefore, with respect to this class of transactions, we conclude that petitioner has not sustained his burden of proving the amount of the receipts exempt from taxation (Rev. & Tax. Code § 6091).

For the reasons stated, it is hereby ordered that the taxes be redetermined as originally determined.

Done at Sacramento, California, this 7th day of August 1969.

John W. Lynch, Chairman
George R. Reilly, Member
Paul R. Leake, Member
Attested by: H. F. Freeman, Executive Secretary

EMBASSY SUITES, INC.

A hotel serving complimentary breakfasts and beverages to its guests in connection with the rental of a hotel room, without a separate charge, may be a consumer of the food and beverages if the retail value of the food and beverages is ten percent or less of the average daily rate for that hotel for the preceding year.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petitions for Redetermination of EMBASSY SUITES, INC., EMBASSY SUITES, INC., ARCADIA BONHEUR, INC. U.S.A., BUENA PARK HOMTEL ASSOC. LTD. PTN., BUENA PARK HOMTEL ASSOC. LTD. PTN., EMBASSY SUITES, INC., EMBASSY SUITES, INC., EPT COVINA LIMITED PARTNERSHIP, EPT COVINA LIMITED PARTNERSHIP, EMBASSY SUITES, INC., EMBASSY SUITES, INC., EMBASSY SUITES CLUB NO. TWO, INC., MORIHIRO SEKIYAMA, MD., EMBASSY SUITES, INC., EMBASSY SUITES, INC., EMBASSY LA JOLLA PARTNERS LMT. PTNR., EMBASSY SUITES, INC., PACIFIC MARKET INVESTMENT COMPANY, EMBASSY SUITES, INC., EPT SANTA CLARA LTD. PARTNERSHIP, *Petitioners*

Appearances:

For petitioners: Mr. Joseph A. Vinatieri, Attorney at Law
Mr. Michael Fannon, Embassy Suites
Mr. Randy Traylor, The Promus Companies, Inc.

For Business Taxes Appeals Section, Legal Division: Ms. Susan M. Wengel, Assistant Chief Counsel

EMBASSY SUITES, INC. (Contd.)

For Sales and Use Tax Department: Mr. Robert W. Lambert
Tax Counsel III

MEMORANDUM OPINION
Corrected by Board Action on October 10, 1996

This opinion considers the merits of a number of petitions under the Sales and Use Tax Law of various Embassy Suites and other legal entities, for various periods, in the total amount of $527,949.68 tax plus interest. Petitioners are hotels serving meals and beverages. They offer hotel guests complimentary breakfasts every morning and bar service for one or two hours every evening. Embassy Suites use an atrium area of the hotel lobby or meeting rooms for the breakfast and bar service.

For breakfast, a self-serve, buffet-style table is maintained with cold and hot food and beverages. Reusable plates and silverware are furnished to the guests. Guests can also receive made-to-order items such as a fried egg breakfast.

For evening beverages, guests are served drinks ordered from a bartender. Mixed drinks are made to order and served in reusable glassware. A variety of bar snacks are available. All personnel involved in serving the breakfasts and evening drinks are hired for a fee from the restaurant and bar located in the hotel.

There was no segregation of the sales of meals and beverages on the guests' checks or in the hotels' records; therefore, the Sales and Use Tax Department's audit established a retail sales price using a ten percent markup to all costs, including the cost of food, beverages, supplies and preparation costs. A tax-paid purchases resold credit was also allowed where appropriate.

OPINION

The hotels provided complimentary food and beverages only to guests of the hotel, with very limited exceptions for ''friends of guests.'' Food and beverages were never provided to the general public.

Renting a particular room entitled a guest to obtain complimentary food and beverages. That guest renting a particular room was never allowed the option of refusing complimentary food and beverages in return for a discounted room rental.

California local governments take the position that the entire charge is ''for the room,'' while the Department views part of the charge as being for food and beverages. Accordingly, local governments impose a transient occupancy tax on the full charge to the hotel customer, including the value of complimentary food and beverages provided, while the Department considers the complimentary food and beverages to be subject to sales tax. Therefore, if we adopted the Department's position, hotels would be subject to tax based on two inconsistent theories asserted by two different levels of government.

EMBASSY SUITES, INC. (Contd.)

According to Regulation 1501, ''Service Enterprises Generally,'' persons engaged in the business of rendering services are consumers, not retailers, of the tangible personal property which they incidentally use in rendering the service. The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service.

A guest of a hotel or motel seeks the service of a room rental from the operator of the facility. A factor in the decision making process of the guest when choosing one facility over another may be that one facility has better towels or provides specific amenities, such as shampoo or hand lotion. Similarly, a decision making factor may be that complimentary food and beverages are offered by one lodging facility. So long as such items are de minimis in value, the true object of the guest remains the lodging service.

Complimentary food and beverages are no different than the amenities which the Board has long recognized as incidental to the providing of the lodging service. In accordance with the regulation, the lodging provider is engaged in the business of providing service and is not a retailer of the soap, shampoo, or food and beverages which are incidentally used in rendering the service.

In order to simplify the administration of the law and to prevent abuses, we established a bright line test. Regulation 1546(b)(2) provides a de minimis exception where the value of parts and materials furnished in connection with repair work is ten percent or less of the total charge. A similar de minimis exception provides a fair and equitable bright line test in the case of complimentary food and beverages provided incidental to lodging services.

In general, tax applies to sales of meals or hot prepared food products furnished by restaurants, concessionaires, hotels, boarding houses, soda fountains and similar establishments whether served on or off the premises. (Regulation 1603(a).) The furnishing, preparing, or serving of complimentary food and drinks is de minimis and incidental when the retail value of the complimentary food and beverages furnished in connection with the rental of a hotel room is ten percent or less of the average daily rate for that hotel for the preceding year. The hotel is the consumer of the complimentary food and beverages and tax applies to the sale of the property to it.

The formula to determine whether complimentary food and beverages are incidental is as follows:

$$\frac{\text{Retail Value of Complimentary Food and Beverages per Occupied Room*}}{\text{Average Daily Rate**}}$$

* ''Retail Value of Complimentary Food and Beverages'' is defined as the cost to the hotel of the food and beverages (both alcoholic and non-alcoholic) marked-up one hundred percent. The term ''cost to the hotel of

EMBASSY SUITES, INC. (Contd.)

food and beverages'' includes the amounts paid by the hotel to vendors, without increase for the food preparation labor of hotel employees, nor the fair rental value of hotel facilities used to prepare or serve meals. The value of such labor and facilities is taken into account in the above formula by use of the 100% mark-up.

** ''Average daily rate'' is defined as the gross room revenue of the hotel for the preceding calendar year divided by the number of rooms rented for that year.

If applying the formula results in the complimentary food and beverages being ten percent or less, such food and beverages are deemed incidental to the lodging, and not subject to sales tax. For example, if the average daily rate for a hotel in 1995 was $80, and the cost of the complimentary food and beverages per occupied room for the same year was $3.00, the retail food and beverages value is less than ten percent ($80 × 10% = $8 > $3.00 × 2 = $6). The hotel is the consumer of the food and beverages and tax applies to its cost, where appropriate.

When a lodging facility provides complimentary food and beverages to its resident guests as part of its service and the requirements of the formula are met, a lodging facility is not a retailer of such food and beverages. We understand that a lodging facility may occasionally sell similar items to friends of guests to accommodate its resident guests (for example, a resident guest may invite a friend or business acquaintance for a breakfast meeting). If a lodging facility regularly sells the otherwise complimentary meals and beverages to the general public, then that facility is a retailer of the food and beverages provided.

At the hearing of Embassy, held on October 25, 1995, the taxpayer introduced as Exhibit ''A'' a statistical recap of the average food and beverage costs for Embassy Suites in California per year. The exhibit also included information regarding the average daily rate/room revenue for those years. When the formula presented above is applied to the figures presented in Exhibit ''A,'' the retail value of the complimentary food and beverages is less than ten percent of the average daily rate. Accordingly, we conclude that the complimentary food and beverages provided are incidental to the service of providing lodging, and sales tax does not apply. We order the petitions be granted in full.

Done at Sacramento, California, this 25th day of July, 1996.

Dean F. Andal, Member

Brad Sherman, Member

Rex Halverson, Member

Attested by E. L. Sorensen, Jr., Executive Director

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THOMAS E. FERRARI

Pollen sold to fertilize plants and trees is regarded as an annual plant the sale of which is exempt from tax.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

DECISION OF THE BOARD

In the Matter of the Petition and Claims for Refund of THOMAS E. FERRARI *Petitioner*

Appearances:

For Petitioner:	Mr. Thomas E. Ferrari, Ph.D. Mr. David R. Firman
For Business Taxes Appeals Review Section, Legal Division:	Mr. Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Mr. John Waid Staff Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination in the amount of $12,158.40 in tax for the period January 1, 1986 through December 31, 1988 and for claims for refund for unspecified amounts for the period January 1, 1989 through December 31, 1991. The Board heard this matter on September 29, 1993.

Petitioner is a sole proprietor engaged in the business of selling pollen and pollen inserts since 1986. Petitioner obtained his Ph.D. in horticulture in 1970 and has worked in the area of pollination and crop productivity for many years.

In 1986 petitioner invented a device for dispensing pollen for which he obtained a U.S. patent. The hive pollen dispenser is a device which is placed in the entrance of a bee hive and is constructed so that the bees are forced to walk through pollen when entering or exiting the hive. The pollen is picked up by the bees and carried to the flowers they visit thus accomplishing cross-pollination. Petitioner's method of supplementing an orchard's natural pollination can be used for a variety of fruit trees.

Petitioner contracts with farmers and collects the pollen from their trees. Petitioner then cleans and disinfects the pollen so that any disease which the pollen is carrying is eliminated. The pure pollen is then sold to farmers who use petitioner's pollen dispenser to supplement the natural pollination of their trees. When wind is the natural pollinator, petitioner's pollen may be sprayed onto the trees or placed in a bag that is shaken over the trees.

THOMAS E. FERRARI (Contd.)

The Sales and Use Tax Department audited petitioner's business and concluded that all sales of pollen were subject to sales tax. The Department relied on Sales and Use Tax Annotation 510.1260 dated June 25, 1970 which provides that the sale of walnut pollen ''artificially'' introduced into walnut blossoms to effect pollination was subject to sales tax because the walnut pollen was not sold for incorporation into a product for resale.

Petitioner contends that this annotation is incorrect and that sales of pollen qualify for exemption under Revenue and Taxation Code Section 6358(c) which exempts sales of seeds and annual plants the products of which ordinarily constitute food for human consumption or are sold in the regular course of business. In support of his position, Dr. Thomas E. Ferrari, PhD has stated that pollen is an autonomous, free-living organism during part of its life cycle. Pollen, termed a haploid, can undergo a series of developmental changes in form, with its function in life being to reproduce itself. To do so, the pollen must grow and the sperm cells contained within the pollen must fuse with an egg (another haploid organism). At this point, the autonomous life of pollen ends and upon fusion with an egg becomes a different organism (a diploid). This new organism has a life cycle of its own and can be annual, like garden vegetables, or perennial, like an oak tree. The pollen, however, is regenerated annually during bloom and has its own life cycle.

Dr. Ferrari goes on to clarify that the alternation of haploid and diploid phases, termed generations, occur throughout the plant kingdom. He rationalizes the pollen situation as a ''life cycle within a life cycle''. In pollen, the haploid and the diploid stages have their own individual life forms which occur sequentially and at least for pollen occur annually.

OPINION

Revenue and Taxation Code Section 6358(c) provides that there are exempted from the taxes imposed by this part the gross receipts from the sales of and the storage, use, or other consumption of seeds and annual plants the products of which ordinarily constitute food for human consumption. This statute is further clarified in Sales and Use Tax Regulation 1588(a) which provides that tax does apply to sales of nonannual plants, such as fruit trees, regardless of the fact that the products will be sold or used as food for human consumption.

While clearly the trees themselves do not qualify for exemption, the product sold by petitioner is the pollen from these trees. Dr. Ferrari has testified that the pollen is itself a plant that is regenerated annually so that the fruit can be produced. It starts its life cycle in the form of a haploid, a recognized phase in the plant kingdom, and ends its life cycle when it fuses with an egg which will ultimately mature into the fruit or nut. We conclude that the pollen meets the definition of an annual plant in Revenue and Taxation Code Section 6358(c).

We also conclude that Sales and Use Tax Annotation 510.1260 dated June 25, 1970 is inconsistent with this conclusion and should be deleted.

THOMAS E. FERRARI (Contd.)

Done at Sacramento, California, this 30th day of June, 1994.

Brad Sherman, Chairman
Matthew K. Fong, Member
Ernest J. Dronenburg, Jr., Member
Windie Scott, Member
Attested by: E. L. Sorensen, Jr., for Executive Director

DAVID R. FIRMAN

Pollen sold to fertilize plants and trees is regarded as an annual plant the sale of which is exempt from tax.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

DECISION OF THE BOARD

In the Matter of the Petition and Claims for Refund of DAVID R. FIRMAN *Petitioner*

Appearances:

For Petitioner:	Mr. David R. Firman Mr. Thomas E. Ferrari, Ph.D.
For Business Taxes Appeals Review Section, Legal Division:	Mr. Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Mr. John Waid Staff Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination in the amount of $12,158.40 in tax for the period January 1, 1986 through December 31, 1988 and for claims for refund for unspecified amounts for the period January 1, 1989 through December 31, 1991. The Board heard this matter on September 29, 1993.

Petitioner is a sole proprietor engaged in the business of collecting and selling pollen since 1986. Petitioner contracts with various farmers to acquire the right to collect pollen from the farmer's trees. Once the pollen is collected it is cleaned and disinfected so that any disease which the pollen is carrying can be eliminated. The pure pollen is then sold to other farmers and is either sprayed on trees or placed in a bag and shaken over trees to achieve cross-pollination. These methods are used if wind is the natural pollinator. If bees are the natural pollinator, a hive pollen dispenser is placed in the entrance of the bee hive. The dispenser is constructed so that the bees are forced to walk through the pollen when entering

DAVID R. FIRMAN (Contd.)

or exiting the hive. The pollen is picked up by the bees and carried to the blossoms the bees visit, thus accomplishing cross-pollination.

The Sales and Use Tax Department audited petitioner's business and concluded that all sales of pollen were subject to sales tax. The Department relied on Sales and Use Tax Annotation 510.1260 dated June 25, 1970 which provides that the sale of walnut pollen ''artificially'' introduced into walnut blossoms to effect pollination was subject to sales tax because the walnut pollen was not sold for incorporation into a product for resale.

Petitioner contends that this annotation is incorrect and that sales of pollen qualify for exemption under Revenue and Taxation Code Section 6358(c) which exempts sales of seeds and annual plants the products of which ordinarily constitute food for human consumption or are sold in the regular course of business. In support of this position, petitioner's representative, Dr. Thomas E. Ferrari, PhD has stated that pollen is an autonomous, free-living organism during part of its life cycle. Pollen, termed a haploid, can undergo a series of developmental changes in form, with its function in life being to reproduce itself. To do so, the pollen must grow and the sperm cells contained within the pollen must fuse with an egg (another haploid organism). At this point, the autonomous life of pollen ends and upon fusion with an egg become a different organism (a diploid). This new organism has a life cycle of its own and can be annual, like garden vegetables, or perennial, like an oak tree. The pollen, however, is regenerated annually during bloom and has its own life cycle.

Dr. Ferrari goes on to clarify that the alternation of haploid and diploid phases, termed generations, occur throughout the plant kingdom. He rationalizes the pollen situation as a ''life cycle within a life cycle''. In pollen, the haploid and the diploid stages have their own individual life forms which occur sequentially and at least for pollen occur annually.

OPINION

Revenue and Taxation Code Section 6358(c) provides that there are exempted from the taxes imposed by this part the gross receipts from the sales of and the storage, use, or other consumption of seeds and annual plants the products of which ordinarily constitute food for human consumption. This statute is further clarified in Sales and Use Tax Regulation 1588(a) which provides that tax does apply to sales of nonannual plants, such as fruit trees, regardless of the fact that the products will be sold or used as food for human consumption.

While clearly the trees themselves do not qualify for exemption, the product sold by petitioner is the pollen from these trees. Dr. Ferrari has testified that the pollen is itself a plant that is regenerated annually so that the fruit can be produced. It starts its life cycle in the form of a haploid, a recognized phase in the plant kingdom, and ends its life cycle when it fuses with an egg which will ultimately mature into the fruit or nut. We conclude that the pollen meets the definition of an annual plant in Revenue and Taxation Code Section 6358(c).

We also conclude that Sales and Use Tax Annotation 510.1260 dated June 25, 1970 is inconsistent with this conclusion and should be deleted.

DAVID R. FIRMAN (Contd.)

Done at Sacramento, California, this 30th day of June, 1994.

Brad Sherman, Chairman
Matthew K. Fong, Member
Ernest J. Dronenburg, Jr., Member
Windie Scott, Member
Attested by: E. L. Sorensen, Jr., for Executive Director

JACK DONALD FREELS

When a closely held corporation is suspended by the Secretary of State, the officers-shareholders will be held personally liable for sales taxes incurred by the business during the period of the suspension if they continue to conduct selling activities and collect sales tax reimbursement from customers. The reason for the corporate suspension will not affect this conclusion. When the officers-shareholders of a suspended corporation continue to do business, they do so as individuals. As such, if they continue the selling activities of the suspended corporation, they are themselves sellers required to obtain a seller's permit and to report and remit sales tax to the State.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim for Refund of JACK DONALD *Claimant*

Appearances:

For Claimant:	Mr. Spencer T. Malysiak Attorney at Law
For Business Taxes Appeals Section, Legal Division:	Ms. Susan M. Wengel Assistant Chief Counsel

MEMORANDUM OPINION

This opinion considers the merits of the claim for refund under the Sales and Use Tax Law for Jack Donald Freels as follows:

1. Liability for tax on sales by a suspended corporation for the period August 15, 1990 through June 15, 1992, in the amount of $34,152.94;

2. Claimant's bank account was levied upon for $65,194.89, which is the subject of claimant's refund.

This claim was originally heard by the Board on May 3, 1995, at which time the Board ordered the claim to be held in abeyance pending the Sales and Use Tax Department's investigating the liability of Mr. and Mrs. Christiansen, who Mr. Freels claims are the true owners. On April 10, 1997, on an Adjudicatory Calendar, the matter was returned to the Board. At that time the Board directed the Appeals Section to prepare a Memorandum Opinion.

JACK DONALD FREELS (Contd.)

Claimant is the President and owner of Capital Video Incorporated, a corporation which rented video tape films. The corporation did not hold a seller's permit.

The corporation began operations on July 1, 1984. On August 15, 1990, the corporate charter was suspended by the Secretary of State. The business continued to operate until June 15, 1992. Sales tax reimbursement was collected but not remitted to the Board.

The Sales and Use Tax Department audited claimant and the corporation but no records were provided. To establish gross receipts for the corporation for the period from July 1, 1984 through June 30, 1989, the auditor used Federal Income Tax Returns. Because no records were provided for the later periods, average quarterly gross receipts for the period July 1, 1988 through June 30, 1989, were used to estimate taxable sales made in those periods.

A Notice of Determination was mailed to the corporate address obtained from the Office of the Secretary of State as neither the corporation nor claimant held a seller's permit or provided the Department with an address. No response was received and the determination became final.

In addition to the determination issued to the corporation, dual determinations were issued to claimant. The determination for the period July 1, 1984 through August 14, 1990 was based on corporate officer liability pursuant to Revenue and Taxation Code section 6829. The Department concluded that because claimant was the owner and president of a corporation that had been terminated, and because tax was collected from customers, he should be liable for the tax, interest, and penalties due from the corporation for the period in which the business was operated by the corporation.

The second determination was for the period from August 15, 1990 through June 15, 1992 and was based on unreported sales by claimant. The Department found that because a corporation is an artificial person which exists only by reason of being chartered by the State, once a charter is suspended, the corporation cannot operate. In other words, if the business of the corporation continues, it must be operated by individuals. This determination, against claimant as an individual, included tax, interest and penalties for failing to file returns and for knowingly operating without a seller's permit.

Claimant's bank account was levied upon for $65,194.89, which is the subject of claimant's claim for refund.

This matter was heard by the Board on May 3, 1995. Claimant contended that the claim should be granted but the Board ordered the claim to be held in abeyance pending the Department locating and determining that a billing to Mr. and Mrs. Christiansen, who, claimant alleged, were the owners and operators of the business during the period August 15, 1990 through June 15, 1992, was appropriate. Action on the claim for refund was not to be taken until after the Christiansen matter was resolved.

The Department investigated the Christiansens but did not request a determination because the Department found that the Christiansens did not have any attachable assets or income. The liability had been paid in full by claimant so

JACK DONALD FREELS (Contd.)

there was no liability to bill unless claimant received a refund. Additionally, the Department has a policy of issuing a dual determination only if attachable assets or income can be located.

On June 30, 1980, the Board adopted a policy of asserting tax against corporate officers of closely held corporations when sales tax reimbursement has been collected from customers and the corporation's powers, rights, and privileges have been suspended by the Franchise Tax Board for failure to pay the franchise tax. The Sales and Use Tax Department had construed this to include all suspended corporations.

On November 15, 1995, the Board, in deciding an unrelated petition for redetermination, ordered that this particular petition be granted because the corporate suspension was not for failure to pay taxes to the Franchise Tax Board. In relying on this direction from the Board, the Appeals Section requested that the Department contact the Franchise Tax Board and ascertain if the corporate suspension for claimant's corporation was based on Capital Video, Incorporated's failure to pay taxes to the Franchise Tax Board. The Appeals Section, once they were advised that the suspension was not for failing to pay the Franchise Tax Board, narrowly construed the Board's 1980 policy and recommended that as to the liability incurred by claimant from August 15, 1990 through June 15, 1992, the claim should be granted.

The issue presented in this Memorandum Opinion is whether the claim for refund should be granted because the corporation was not suspended for failing to pay its taxes to the Franchise Tax Board. We conclude that it should not.

There is both a statutory basis and a basis in California case law upon which to assert personal liability for tax assessments against the officers-shareholders of a closely held corporation which has been suspended by the Secretary of State but continues to conduct selling activities and collects sales tax reimbursement from customers. In *Decorative Carpets, Inc.* v. *State Board of Equalization* (1962) 58 Cal.2d 252, the California Supreme Court concluded that excessive sales tax reimbursement collected by a retailer gave rise to an involuntary trust with the retailer acting as the involuntary trustee of the funds. When these funds were paid to the Board of Equalization, the Board could insist on the retailer refunding the excess tax reimbursement to the customers as a condition to the Board's refunding of the overpayments to the retailer. The court noted that the Board ''has a vital interest in the integrity of the sales tax . . . '', and that ''[t]o allow (the retailer) a refund without requiring it to repay its customers the amounts erroneously collected from them would sanction a misuse of the sales tax by a retailer for his private gain.'' (at page 255) Therefore, officers-shareholders of a closely held corporation who continue to operate a business which has had its corporate powers suspended and continue to collect sales tax reimbursement from the customers of that business are involuntary trustees of those funds. For the Board to permit the corporate officers-shareholders to retain those funds

JACK DONALD FREELS (Contd.)

sanctions a misuse of the sales tax by them for their private gain and undermines the integrity of the sales tax. These funds are collected as sales tax reimbursement from customers and are a debt owed by the business to the State of California.

Under the statutory provisions of the Sales and Use Tax Law there is further authority to hold officers-shareholders of a suspended corporation liable for the sales tax which the business owes the State and has already collected from customers as sales tax reimbursement. The officers of a corporation are the persons who conduct the business of the corporation, and if the Board were to pursue someone other than the corporation for liabilities generated during the period of suspension the persons to pursue are the persons who conduct the business.

Revenue and Taxation Code section 25962.1 makes it a crime for any person to purport to exercise the powers of a corporation which has been suspended pursuant to Revenue and Taxation Code section 23301. When corporate officers-shareholders conduct selling activities during a period in which the corporate powers are suspended they are not exercising the corporate powers but are acting as individuals. Revenue and Taxation Code sections 6014, 6015, and 6066 indicate that the officers-shareholders as individuals are sellers within this state and must hold a seller's permit. As the Sales and Use Tax Law, by its own terms, applies to claimant's actions of engaging in selling activities during the period of suspension of the corporation's powers, it is appropriate to treat claimant as one engaged in an activity requiring the holding of a seller's permit. The reason for the corporate suspension will not affect this conclusion. It is the fact that the corporation is suspended and yet the officers-shareholders as individuals continue the selling activities that triggers the officers-shareholders' responsibility as sellers to obtain a seller's permit and to report and remit sales tax to the State.

OPINION

We conclude that the claim for refund be denied. To the effect that any Board publications, policies, or annotations are inconsistent with this Memorandum Opinion, we further conclude that this Memorandum Opinion will have precedence.

Done at Sacramento, California, this 10th day of September, 1997, by the State Board of Equalization.

Ernest J. Dronenburg, Jr., Chairman

Johan Klehs, Member

Dean F. Andal, Member

Rex Halverson, Member*

John Chiang, Member**

* For Kathleen Connell, per Government Code section 7.9.

** Acting Member, 4th District

FRESCO SALES, INC.

At the request of a dealer, a "home party" hostess would invite her friends and acquaintances to her home for a merchandise party at a scheduled time arranged with the dealer. That dealer would attend, display merchandise, distribute promotional materials, solicit orders for merchandise, and solicit those present to hold future merchandise parties. The hostess would be advised before the party of the general method which would be used to award her "gifts". The effort and sponsorship necessary to hold the party is good consideration for the "gifts". Therefore, the "gift" merchandise was sold to the hostesses.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of FRESCO SALES, INC. *Petitioner*

Appearances:

For Petitioner: Theodore Pappas
Tax Counsel, Dart Industries, Inc.
Joe Trepani
Vice President, Tupperware Home Parties, Inc.

For Staff: Philip R. Dougherty
Tax Counsel

MEMORANDUM OPINION

This is a petition for redetermination of sales tax in the amount of $6,324.85, for the period January 1, 1968 to June 30, 1971.

Fresco Sales, Inc. (hereinafter "Fresco"), engaged in business as a Tupperware distributor selling Tupperware (proprietary plastic housewares) and sales materials to its independent-contractor dealers. The dealers sold the Tupperware at retail through the "Tupperware Home Party" merchandising method. During the period in question, Fresco reported its dealers' sales on its returns pursuant to the board's (R.T.C. section 6015) determination that Fresco should be regarded as the retailer for Sales and Use Tax Law purposes. The board issued a deficiency determination against Fresco for the period in question, and Fresco petitioned for a redetermination. The issues presented are: (1) whether Fresco's dealers sold "gift" merchandise to party hostesses in exchange for the parties; and (2) what amount of "gross receipts" were received by the dealers from the sales of "gift" merchandise.

The Tupperware Home Party method which Fresco urged on its dealers is illustrated by the printed materials which Fresco provided for its dealers' use. At the request of a dealer, a "home party" hostess would invite her friends and acquaintances to her home for a "Tupperware party" at a scheduled time arranged with the dealer. That dealer would attend, display Tupperware merchandise, distribute promotional materials, solicit orders for Tupperware, and solicit those present to hold future Tupperware parties. The number of persons attending, the amount of merchandise ordered, and the number of future party appointments scheduled at each party would determine "gift stars" earned by that party's hostess. Near the end of each party the dealer would compute the "gift stars" earned and offer the hostess a choice of gifts displayed in a brochure. The

FRESCO SALES, INC. (Contd.)

value of each non-Tupperware gift would be displayed in ''star'' rather than money amounts, and the hostess would select the gift or gifts which had ''star'' values which in the aggregate did not exceed the number of stars she had earned. Alternatively, the hostess could select items of Tupperware at the rate of 50 cents worth of Tupperware for each star earned. The ''gifts'' selected by the hostess would be delivered to her along with all the Tupperware ordered by those at her party. The hostess was expected to collect from the guests the price of the Tupperware they ordered and to deliver the Tupperware to them after it had been delivered to her.

The dealer, following the general guidelines of Fresco's distributed materials, urged prospective hostesses to hold parties. The printed brochure for hostesses who volunteered contained the method of computing the ''stars'' and urged them to earn ''star'' credits used to compute the ''hostess gifts'' they could receive. Guest brochures for party guests do not describe the computation, but did encourage guests to become hostesses and earn their own ''gifts''. In short, the text of all of the materials assumed the prospective hostess would be advised before the party of the general method which would be used to award her ''gifts''. The petitioner has presented no evidence that its dealers did not follow the outlined methods.

Section 6006(a) defines sales to include in part:

> ''Any transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration.''

Fresco's dealers represented to prospective hostesses that if the hostess did hold Tupperware parties, they would so earn stars entitling them to ''free gifts''. That constituted an offer to compensate the hostess which the hostess could accept by holding the Tupperware party. The effort and sponsorship necessary to hold the party is good consideration for the dealer's promise (cf. Civ. Code, section 1605), and therefore we hold that the ''gift'' merchandise was sold to the hostesses, within the meaning of section 6006.

To propose, as does petitioner, that the transfer of the ''gift'' merchandise was not for a consideration because the hostesses gave parties in order to enjoy themselves or in order to buy Tupperware is to confuse the consideration for the contracts with the suggested motives of the hostesses (cf. Williston on Contracts, 3rd.Ed., § 111).

If it were true that the dealers made no statements and distributed no brochures which would reasonably lead prospective hostesses to believe that they would be able to choose ''gifts'' as a reward for holding the party, then it would be possible to conclude that the dealers intended no offer which hostesses might accept. But Fresco's dealers' training materials and sales materials were intended to create that expectation in hostesses and that circumstance controls the matter presented by this petition.

Section 6051 imposes the sales tax on retailers at a specified percentage of their gross receipts from the sale of tangible personal property sold at retail in this state. Section 6012, defining the term ''gross receipts'', includes the total amount

FRESCO SALES, INC. (Contd.)

of the sales price, valued in money, whether received in money or otherwise. Having concluded that Fresco's dealers sold the ''gift'' merchandise in exchange for the hostesses' parties, the value of the parties must be determined so that it can be included in ''gross receipts''. Because the hostesses' efforts could not be directly valued, the audit assumed that the parties were worth the ''stars'' received for them, which were valued at 50 cents per star for the purchase of Tupperware. Therefore, all the ''gift'' merchandise was considered to have been sold for a value of 50 cents per ''star'' redeemed. No better method of valuation has appeared.

The determination, accordingly, is hereby redetermined without change.

Done at Sacramento, California, this 18th day of September, 1973.

William M. Bennett, Chairman
George R. Reilly, Member
John W. Lynch, Member
Richard Nevins, Member
Attested by: W. W. Dunlop, Executive Secretary

GENERAL ATOMICS

An entity is under contract with the U.S. Government to acquire property using grant funds provided by the U.S. Government. The contract provides that title to the property acquired using grant funds will vest in the U.S. Government. The contract also provides that the property will be purchased for use by universities or colleges. The entity purchases the property for use by a university or college and that property is delivered directly to the university or college. In these particular transactions, when the entity acquires that property, it is doing so on behalf of the U.S. Government. Thus, title to the property passes from the vendor to the U.S. Government and from the U.S. Government directly to the college or university. As the entity acquiring the property never holds title to the property, that entity has not incurred a tax liability.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

DECISION OF THE BOARD

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of GENERAL ATOMICS *Petitioner*

Appearances:

For Petitioner:	Janet Pass Accountant
For Appeals Section, Legal Division:	Susan M. Wengel Assistant Chief Counsel

GENERAL ATOMICS (Contd.)

For Sales and Use Tax Department: David Levine
Supervising Tax Counsel

Sophia Chung
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination in the amount of $345,749.57 in tax for the period April 1, 1989, through June 30, 1992. The Board heard this matter on September 11, 1996, and took it under consideration. On November 21, 1996, on a Final Action Calendar, the Board granted the petition and requested the Appeals Section to prepare a Memorandum Opinion.

The San Diego Supercomputer Center (SDSC), a division of petitioner, operates a supercomputer center for the National Science Foundation (NSF). SDSC is located at the San Diego University of California campus. NSF awarded SDSC a fee bearing grant under which SDSC would implement a federal plan to connect various California state universities to the NSF's National Supercomputer Access Network. Under the program, SDSC acquires some of the equipment required for the networking program.

Petitioner acquires the computer equipment extax from California vendors with grant funds provided to petitioner by the U.S. Government. Petitioner's purchase orders specify that the equipment is to be delivered directly to the California universities and colleges. Title vests in the institutions.

The NSF Grant General Conditions, Article 7, ''Equipment'' which provides for acquisitions of equipment with NSF grant funds, reads as follows:

> ''Title to equipment purchased or fabricated with NSF grant funds for use by a college or university or other nonprofit organization shall vest in that institution, with the understanding that such equipment (or a suitable replacement obtained as a trade-in) shall remain in use for the specific project for which it was obtained.
>
> ''Title to equipment purchased or fabricated with NSF grant funds for use by the grantee organization shall vest in the Government. Such equipment shall be managed in accordance with the NSF Grant Policy Manual.''

Petitioner stated that it only acted as a conduit for the government with respect to the equipment acquisitions as title to the equipment remained with the U.S. Government. Petitioner stated that title to the property passed to the educational institution directly from the U. S. Government even when the equipment is first acquired by a commercial enterprise such as petitioner. Petitioner does not hold title to the equipment and makes no charge to the California institutions.

OPINION

Revenue and Taxation Code section 6381(a) provides that there are exempted from the sales taxes the gross receipts from the sale of any tangible personal property to the U.S. Government, its unincorporated agencies, and instrumentalities. Therefore, when petitioner acquires the computer equipment

GENERAL ATOMICS (Contd.)

extax, its acquisitions were made on behalf of the U.S. Government. By contract, petitioner could not hold title to the computer equipment and the funds for the acquisitions were provided by the U.S. Government. We conclude that in these particular transactions, title passed from the vendor to the U.S. Government and from the U.S. Government directly to the universities. As petitioner never held title to the equipment, petitioner has not incurred a tax liability.

Adopted at Sacramento, California, this 8th day of May, 1997.

Ernest J. Dronenburg, Jr., Chairman
Johan Klehs, Member
Dean F. Andal, Member
Rex Halverson, Member*
John Chiang, Member**
Attested by E. L. Sorensen, Jr., Executive Director

* For Kathleen Connell, per Government Code section 7.9.

** Acting Member, 4th District.

GIFT EXCHANGE BUSINESSES

The operator of a gift exchange is subject to sales tax on its exchanges. The measure of tax is the agreed value of the customer's trade-in plus the amount charged by the operator.

OPINION OF THE STATE BOARD OF EQUALIZATION REGARDING THE APPLICATION OF SALES TAX TO GIFT EXCHANGE BUSINESSES

A question has arisen concerning the application of sales tax to the operator of a gift exchange business. A typical operation is as follows:

The operator advertises that he will accept new items at their retail value in exchange for other items. A customer brings in a new item of tangible personal property, frequently a gift which he has received, and selects an item in the operator's stock. The operator establishes the retail value of the customer's item from a current list and allows that value against the price marked on the item in stock, adding a charge equal to 20 percent of the retail value of the customer's item. For example, if the retail value of the customer's item is $10 and the price marked on the item in stock is $10, the operator will take the customer's item plus $2 in exchange for the item selected by the customer.

The following authorities control the application of tax to transactions of the kind described above:

1. Section 6006 of the Sales and Use Tax Law, which provides that ''sale'' includes any transfer of title or possession, exchange or barter, of tangible personal property for a consideration.

2. Section 6012 of the Sales and Use Tax Law, which provides that ''gross receipts'' mean the total sale price of the retail sales of retailers, valued in

GIFT EXCHANGE BUSINESSES (Contd.)

money, whether received in money or otherwise, that that sale price includes any services that are a part of the sale, all receipts, cash, credits and property of any kind, and any amount for which credit is allowed to the purchaser.

3. Sales and Use Tax Ruling 65, which provides that the amount upon which tax is computed includes the agreed allowance for property traded in.

Applying the foregoing authorities to the facts described herein, it is the opinion of this board that the operator of a gift exchange is subject to sales tax on his exchanges and that the measure of tax is the agreed value of the customer's trade-in plus the amount charged by the operator as a percentage of that value. In the example given in the facts stated above, the measure of sales tax on the operator is $12.

Done at Sacramento, California, this 4th day of June, 1969, by the State Board of Equalization.

John W. Lynch, Chairman
Paul R. Leake, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

HEWLETT PACKARD COMPANY

Claimant, a computer manufacturer, makes donations of sophisticated computers or scientific equipment to educational institutions and other qualified nonprofit organizations located both in California and out of state. Claimant's gift documents include a provision which states that title to the donated property does not pass to the out-of-state donee until delivery by common carrier and that claimant retains the ability to recall the gift before it reaches the out-of-state destination. The agreement between claimant and its donees includes warranties which become effective upon delivery to, and acceptance by, the donee; and claimant does not take an income tax deduction until the donee receives the gifts. Thus, the gift was made out of state, and the gift is not subject to tax. (Rev. & Tax. Code, § 6009.1.)

However, when the risk of loss and damage pass to the donee at claimant's California plant, a taxable use is made in this state and tax applies with respect to those donations. (Cal. Code Regs., tit. 18, § 1670.)

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matters of the Claims for Refund under the Sales and Use Tax Law of HEWLETT PACKARD COMPANY

Appearances:

For Claimant: Mr. Joseph A. Vinatieri
Attorney At Law
Mr. Jason C. DeMille
Attorney at Law

HEWLETT PACKARD COMPANY (Contd.)

For Appeals Section:	Mr. John Abbott Supervising Tax Counsel
For Sales and Use Tax Department:	Mr. David H. Levine Acting Assistant Chief Counsel
	Ms. Janice Thurston Senior Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of claims for refund under the Sales and Use Tax Law for the period January 1, 1989, through October 31, 1991, for unspecified amounts. The Board heard this matter on March 15, 2000.

Claimant, a manufacturer of computers, makes donations of electronic equipment and software to educational institutions and other qualified nonprofit organizations located both in California and out of state. Typically, claimant receives a request from a professor of an out-of-state university for sophisticated computers or scientific equipment. The request is reviewed by a committee of scientists and engineers before a decision is made to approve the grant on its merits. Once approved, the professor signs the ''Terms and Conditions of Gift'' (Terms) and the order is processed. These donations are not the type of gift that are given just to enhance sales, rather the gifts support education and research. The donated equipment is removed from inventory in California and shipped to the universities. The claims for refund of the use tax relate to taxes paid for donated scientific equipment shipped via common carrier to out-of-state educational institutions.

Claimant contends that the gift is given outside of California and that there is no use of the donated property in this state. In support of its position, claimant states that it self insures its products during delivery and that it does not transfer title of the donated property to the donee until the common carrier delivers the equipment to the donee. Claimant states it has numerous business reasons for making the gift out of state.

Claimant states that the gift is governed by a document (Terms) which provides that ''title to hardware products and risk of loss and damage will pass to Recipient at destination. However, when products are shipped under Recipient's shipping instructions, title and risk of loss and damage shall pass to Recipient at HP's plant.'' Claimant's purpose in retaining title until the common carrier delivers the property includes claimant's ability to recall the property before it reaches the donee. Claimant also points out that since title to the donated property does not vest in the donee until after delivery, claimant does not take an income tax deduction until the date the gift is completed.

Claimant states that its contracts include warranties against defects in materials and workmanship. Claimant further contends that because the computers and instruments are scientific in nature, they are often tested and calibrated after delivery so that they are working properly before they are accepted. With respect to claimant's donated products, the warranty period begins either on the date of delivery or on the date of installation if claimant installed the product.

HEWLETT PACKARD COMPANY (Contd.)

An excise tax is imposed on the storage, use or other consumption of the property in California purchased from a retailer (Rev. & Tax. Code, §§ 6201 and 6202). ''Use'' is defined as exercising any right or power incident to ownership, except sales in the regular course of business or subsequent use solely outside the state. (Rev. & Tax. Code, §§ 6008 and 6009.)

''Storage'' and ''use'' do not include the keeping, retaining, or exercising any right or power over tangible personal property for the purpose of transporting it outside the state for use thereafter solely outside the state (Rev. & Tax. Code § 6009.1). Claimant's withdrawals of inventory items purchased for resale, but donated to out-of-state donees, will not be subject to California use tax if the gift is completed outside of California.

In order for us to find that the gift was made outside of California, claimant must demonstrate that the gifts at issue were not completed until delivery to the donee out of state. In coming to our conclusion that the gifts in this case were completed out of state we gave the following facts significant weight:

(1) The gift documents include a provision which states that title does not pass to the out-of-state donee until delivery by common carrier and that claimant retains the ability to recall the gift before it reaches the out-of-state destination;

(2) The agreement between claimant and its donees includes warranties which become effective upon delivery to, and acceptance by, the donee; and

(3) Claimant does not take an income tax deduction until the donee receives the gift.

We also considered other factors that indicated the intent was to complete the gift outside California, including the fact that the gifts required the donor's personnel to install, test or calibrate the equipment at the donee's out-of-state location.

It is our opinion that claimant demonstrated that the gift was completed out of state and that the gifts claimant made to out-of-state universities are not subject to the use tax pursuant to section 6009.1 of the Revenue and Taxation Code.

This case can be distinguished from *Yamaha Corp. of America* v. *State Bd. of Equalization* (1999) 73 Cal.App.4th 338. In Yamaha the court found that Yamaha intended to make the gift when it delivered the property to the common carrier. There was no written agreement between the parties as to when title to the goods given away was to pass, and there were no business reasons to indicate that Yamaha's gifts were made on delivery to the out-of-state location.

Not all of claimant's gifts meet the requirements of Revenue and Taxation Code section 6009.1. When claimant ships products under the donee's shipping instructions, the ''Terms and Conditions of Gift'' provide that title and risk of loss and damage shall pass to the donee at claimant's California plant. In those cases, claimant's donations are made in California when it places the property in the hands of the common carrier. Therefore, a taxable use is made in this state and the use tax applies with respect to those donations. (Cal. Code Regs., tit. 18, § 1670.)

HEWLETT PACKARD COMPANY (Contd.)

OPINION

We conclude that, pursuant to Revenue and Taxation Code section 6009.1, a gift is not subject to use tax when claimant demonstrates that the gift was in fact made outside California in the manner described in this opinion, or in a manner substantially similar to that described in this opinion.

Done at Sacramento, California this 15th day of June, 2000.

Dean Andal, Chairman
Claude Parrish, Member
John Chiang, Member
Marcy Jo Mandel, Member*

* For Kathleen Connell, per Government Code section 7.9.

HOLIDAY WORLD, INC.

A retailer that delivers tangible property to a known California resident at an out-of-state location is required to collect use tax, unless it obtains a section 6247 statement from the purchaser at the time of the sale that the property was not purchased for use in California.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of HOLIDAY WORLD, INC.

Appearances:

For Petitioner:	Suzanne Beaudelaire Representative
For Sales and Use Tax Department:	Jeff Graybill Tax Counsel
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the audit period January 1, 1995, through September 30, 1996. At the Board hearing, petitioner protested on several grounds a portion ($171,481.29) of a determination representing disallowed interstate commerce sales established on an actual basis.

Petitioner, a corporation, is engaged in the business of selling recreational vehicles (RVs). Among other things, the Sales and Use Tax Department disallowed certain sales in interstate commerce even though petitioner had the RVs delivered out-of-state, since there was evidence that the customers were known California residents and petitioner did not obtain the statement required by Revenue and Taxation Code (''RTC'') section 6247 (''6247 statement'') at the time of the sale. Thus, the Department concluded that although these sales were

HOLIDAY WORLD, INC. (Contd.)

not subject to sales tax, absent the required 6247 statement, the property sold was presumed to be purchased for storage, use or other consumption in this state, and stored, used or otherwise consumed in this state, and petitioner was required to collect use tax from the purchasers at the time of making the sales at issue. (Rev. & Tax. Code, §§ 6203 and 6247.)

Petitioner provided statements made after-the-fact from these purchasers that they purchased their respective RVs for use outside of California. Petitioner asks the Board to accept these after-the-fact statements, since it contends RTC section 6247 does not provide that the retailer can only avoid use tax liability by obtaining a 6247 statement at the time of sale. Petitioner also contends that it did not know whether these purchasers were in fact California residents.

OPINION

RTC section 6247 raises a presumption that tangible personal property delivered outside this state to a purchaser known by the retailer to be a resident of this state was purchased from the retailer for storage, use or other consumption in this state and stored, used or otherwise consumed in this state. This presumption may be controverted by a statement in writing, signed by the purchaser or the purchaser's authorized representative, and retained by the vendor, that the property was purchased for use at a designated point or points outside this state. This presumption may also be controverted by other evidence satisfactory to the Board that the property was not purchased for storage, use, or other consumption in this state. (Rev. & Tax. Code, § 6247).

We find that if a retailer knows at the time of sale of objective indications of a purchaser's California residency, the retailer is required to collect use tax unless it obtains a 6247 statement from the purchaser at the time of the sale. The objective indications of California residency that we will consider relevant include the maintenance of a family home in California, California bank accounts or business interests, California voting registration, the possession of a California driver's license, or the ownership of California real property. The retailer may not later obtain a 6247 statement from the purchaser to avoid liability for the use tax since it was required to either collect the use tax or obtain the 6247 statement at the time of sale. We require that the retailer obtain the 6247 statement at the time of sale, so it knows how to timely report the sale, i.e., as taxable or nontaxable. Similar to the protection provided by a resale certificate, we allow taxpayers protection against their obligation to collect use tax when they timely obtain a valid 6247 statement.

The retailer's delay in obtaining the 6247 statement is similar to the retailer obtaining a resale certificate after-the-fact. If the retailer does not obtain a 6247 statement at the time of the sale, then the retailer must show the same type of evidence as the California purchaser would, i.e., actual evidence to show the exclusion from use tax is warranted. (See Cal. Code Regs., tit. 18, § 1620, subd. (b)(3).)

With evidence of California driver's licenses, bank accounts, and residential addresses, petitioner had objective indications of its customers' California residency. This is sufficient to require petitioner to either collect the tax or obtain

HOLIDAY WORLD, INC. (Contd.)

a 6247 statement at the time of sale. Petitioner failed to either timely obtain a 6247 statement or, alternatively, to provide documentary evidence that the purchaser was not in fact a California resident, or if a California resident, purchased the property for use outside this state. Accordingly, the petition is denied.

Adopted at Sacramento, California, on August 1, 2001.

Claude Parrish, Chairman
Johan Klehs, Member
Dean F. Andal, Member
Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

INTEL CORPORATION

Agreements which include a license to reproduce a copyrighted or patented item together with the tangible personal property needed to reproduce such property are agreements for two transfers. The transfer of an intangible right which is the license to use the information under the copyright or patent and the transfer of tangible personal property which may consist of engineering notes, schematics, manuals, data base tapes, drawing and test tapes.

In the absence of a contract price for the tangible elements, the tax applies only to the value attributable to the tangible elements including the cost of manufacturing the specific tangible properties.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of INTEL CORPORATION *for Redetermination under the Sales and Use Tax Law*

Appearances:

For Petitioner:	Mr. Ronald B. Schrotenboer Attorney at Law
For Business Taxes Appeals Review Section:	Mr. Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Mr. Robert Nunes Deputy Director Mr. David Levine Staff Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination of sales tax in the amount of $555,552.27 which was heard and taken under consideration by the Board on November 20, 1991 in Sacramento, California.

INTEL CORPORATION (Contd.)

Petitioner entered into a contract with Burroughs Corporation to license to Burroughs a process for producing integrated circuits (ICs) to a design developed by Burroughs. The process was to be transferred to Burroughs so that Burroughs could manufacture the ICs using petitioner's process including patents, copyrights and intellectual property rights. The IC design remained the property of Burroughs. The process design remained the property of petitioner. The ICs could then be manufactured for sale to others by both parties to the contract.

As a part of the contract, petitioner transferred written information, instructions, schematics, database tapes, and test tapes. The database tapes contained the IC design in digitized form defining the tooling coordinates. The test tapes were used to evaluate test ICs produced by Burroughs. Neither the database tapes nor the test tapes had existed previously in the form in which they had been transferred. If the test ICs performed to specification, the process transfer would be regarded as successful. Neither the database tapes nor the test tapes were used to operate equipment, either to produce ICs or tooling.

Petitioner entered into a contract with Advanced Micro Designs (AMD) under which petitioner licensed AMD to produce ICs designed by petitioner using process information designed by petitioner. Both the design and process had been copyrighted or patented by petitioner. Petitioner transferred copies of existing proprietary written information, instructions, schematics, database tapes, and test tapes to AMD similar to the transfers to Burroughs. Neither contract specified a contract price for the tangible elements.

The issue raised by the petition was whether the sales tax should apply to the entire transfer price or only to the amount attributable to the tangible items transferred.

The Board concluded that in agreements of this type there are for sales and use tax purposes, two transfers. One is the tangible personal property which may consist of engineering notes, manuals, schematics, database tapes, drawings and test tapes. The second is the sale of intangible property which consists of the license to use the information under the copyright or patent.

The Board further concluded that in the absence of a contract price for the tangible elements, the tax applies only to the value attributable to the tangible elements including the cost of manufacturing the specific tangible properties. This includes material costs, fabrication labor, and a suitable markup for overhead and profit. While suitable markups vary depending on the industry or taxpayer, the markup considered suitable in this case was 100% of the cost of materials and labor. The value attributable to the intangible elements is not subject to tax.

The Board accepted petitioner's valuation of the tangible elements of $33,000. The Board concluded that the amount subject to tax should be reduced to that amount.

The Board ordered the matter redetermined in accordance with these findings.

INTEL CORPORATION (Contd.)

Done at Sacramento, California, this 4th day of June 1992.

Ernest J. Dronenburg, Jr., Member
Matthew K. Fong, Member
Windie Scott, Member
Attested by: Burton W. Oliver, Executive Director

J. G. BOSWELL COMPANY

All bees, not just honeybees, qualify as a form of animal life of a kind the products of which ordinarily constitute food for human consumption.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of J.G. BOSWELL COMPANY

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period January 1, 1995, through December 31, 1997. Petitioner protested a portion of the determination related to its ex-tax purchases of leafcutter bees. After the Appeals conference and prior to the Board hearing, the Sales and Use Tax Department conceded the leafcutter bees were exempt from tax. Both parties waived appearance at the Board hearing.

Petitioner produced agricultural crops. Petitioner purchased leafcutter bees which petitioner used to pollinate its alfalfa plants. It did not use the leafcutter bees to produce honey for harvesting, as honeybees would be used. Petitioner contended, among other things, that all types of bees, not just honeybees, are exempt from tax as forms of animal life the products of which ordinarily constitute food for human consumption.

OPINION

Subdivision (a) of Revenue and Taxation Code section 6358 exempts from sales or use tax: ''(a) Any form of animal life the products of which ordinarily constitute food for human consumption.'' In interpreting this exemption, the Board has adopted Title 18, California Code of Regulations, section 1587. That section provides in relevant part:

''ANIMAL LIFE, FEED, DRUGS AND MEDICINES.

(a) Animal Life. Tax does not apply to sales of any form of animal life of a kind the products of which ordinarily constitute food for human consumption (food animals), as for example, cattle, sheep, swine, baby chicks, hatching eggs, fish, and bees. . . . '' (Emphasis added).

As provided by the regulation, we conclude that all bees, not just honeybees, are a form of animal life of a kind the products of which ordinarily constitute food for human consumption. It is not relevant that petitioner only used the leafcutter

J. G. BOSWELL COMPANY (Contd.)

bees for pollination, or that the leafcutter bees did not produce honey for harvesting. Accordingly, petitioner's purchase and use of leafcutter bees are exempt from use tax. The petition should be granted.

Adopted at Sacramento, California, on August 1, 2001.

Claude Parrish, Chairman
John Chiang, Member
Dean F. Andal, Member
Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

JOHN DEXTER SHELDON, INC.

The embossing of a consumer furnished blank credit card is an operation which results in the production of the completed credit card ready for use. It constitutes taxable fabrication labor.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of JOHN DEXTER SHELDON, INC., dba MULTI-SERVICE, INC.

Appearances:

For Petitioner: Mrs. Lavon Poindexter
President

For Staff: Mr. J. J. Saunders
Hearing Auditor

MEMORANDUM OPINION

A petition has been filed by John Dexter Sheldon, Inc., dba Multi-Service, Inc., for redetermination of sales and use taxes for the period April 1, 1965, to March 31, 1968, in the amount of $6,059.69, plus statutory interest.

Petitioner manufactures and sells credit cards; embosses credit cards and addressograph plates; performs bookkeeping, billing, and mailing services; and sells forms, envelopes and other items.

The disputed amount represents charges made for embossing credit cards with the names, addresses, etc., of the persons to whom petitioner's customers will distribute the cards.

The embossing, which is done on a graphotype machine, is usually performed at a later date after the blank cards have been manufactured. In some cases the new cards are held by petitioner until petitioner's customer furnishes petitioner with the information to be embossed. In other cases the cards are first delivered to the customer but later returned to petitioner for embossing. In still other cases embossing is done for customers who have purchased the blank cards from other manufacturers.

JOHN DEXTER SHELDON, INC. (Contd.)

The basic issue presented is whether the embossing of blank credit cards constitutes the performance of taxable fabrication labor or the performance of a nontaxable service.

Petitioner contends that embossing is an exempt service similar to addressing envelopes for clients, in that there is no difference between typing names and addresses on envelopes using a manual typewriter and typing names and addresses on credit cards with a graphotype machine.

We find that the tax has been properly applied in this instance.

Section 6012 of the Revenue and Taxation Code provides that ''Gross receipts,'' the measure of the tax, mean the total amount of the sale price of the property sold without any deduction on account of ''the cost of the materials used, labor or service cost . . . or any other expense.'' Thus, where a transaction is regarded as a sale of tangible personal property, tax applies to the gross receipts from the furnishing thereof, without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property.

Ruling No. 24, ''Printing and Related Industries,'' (Cal. Admin. Code 1934), adopted by the board pursuant to the authority granted it by the Legislature in section 7051 of the code to prescribe and adopt rules and regulations relating to the administration and enforcement of the Sales and Use Tax Law, specifically provides that:

> ''Tax applies to charges for services in connection with the sale of printed matter, such as die cutting, *embossing*, folding, and other binding operations, regardless of whether or not the said printed matter is furnished by the customer. [Emphasis added.]

In regard to blank cards furnished by petitioner's customer to petitioner for embossing, section 6006(b) of the code provides that ''Sale'' includes ''the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish directly or indirectly the materials used in the producing, fabricating, processing, printing or imprinting.''

Ruling No. 15, ''Producing, Fabricating and Processing Property Furnished by Consumers—General Rules'' [Superseded as of September 6, 1969, by regulation 1526 (Cal. Admin. Code 1526)] provides that:

> ''Producing, fabricating, and processing [as opposed to repairing and reconditioning] include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property.

We find the embossing of a consumer-furnished blank credit card to be an operation which results in the production of the completed credit card ready for use.

JOHN DEXTER SHELDON, INC. (Contd.)

The analogy drawn by petitioner between embossing names on credit cards and manually addressing envelopes is not persuasive. Charges for the latter service, when performed in connection with the preparation of material for mailing are, if separately stated on invoices and in accounting records, specifically exempted from the sales tax under ruling No. 24 and ruling No. 7.5, ''Mailing House Transactions.'' (Cal. Admin. Code 1907.5.) Even though the embossed credit cards may be mailed in ''window'' envelopes and thus serve for mailing purposes as the addresses of the intended holders, that purpose would only be incidental to the main purpose of the embossing, i.e., to complete credit cards ready for use as such.

For the reasons indicated above, the petition for redetermination is hereby denied.

Done at Sacramento, California, this 5th day of November 1970.

George R. Reilly, Chairman

John W. Lynch, Member

Paul R. Leake, Member

Richard Nevins, Member

Attested by: H. F. Freeman, Executive Secretary

LIFECARE SERVICES, INC.

Respiratory equipment that induces air into the lungs of a patient, through application of pressure to the chest area, qualifies for the exemption as oxygen delivery systems regardless of whether the pressure applied is negative pressure or positive pressure. However, the equipment is not a nontaxable prosthetic device as defined in Regulation 1591(b)(5) since it was not designed to be fully worn on the user.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of LIFECARE SERVICES, INC.

Appearances:

For Petitioner:	Joseph A. Vinatieri Attorney at Law Geoffrey C. Waters Senior Vice President Thomas Petty, M.D.
For Business Taxes Appeals Review Section:	John Abbott Supervising Staff Counsel

LIFECARE SERVICES, INC. (Contd.)

For Sales and Use Tax Department:

Glenn Bystrom
for Robert Nunes
Deputy Director

Gary Jugum
Assistant Chief Counsel

John L. Waid
Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination of sales tax, interest and penalty in the amount of $642,264 which was heard and taken under consideration on October 2, 1992, in Sacramento, California. The Board further considered the matter and arrived at a decision on December 3, 1992.

Petitioner is a manufacturer that sells and rents medical respiratory equipment. Petitioner's respiratory equipment assists patients in breathing.

Petitioner sells/rents certain equipment that provides positive air pressure directly to the patient's breathing passage. Other equipment provides negative pressure to the patient's chest area which in turn causes an inrush of air to the lungs. The difference between the two types of systems is that, in the case of positive pressure, air/oxygen is forced into the patient's lungs, while in the negative pressure systems, air is removed from the area surrounding the chest cavity, causing a low pressure area around that cavity, thus allowing the relatively higher ambient pressure to introduce air into the patient's lungs. An example of this latter type of device is the iron lung. In addition to the iron lung, there are less cumbersome devices that operate on a similar principle and perform the same function. Specifically, the chest shell covers only the chest of the patient; the pulmo-wrap is a suit that is worn and covers the body of the patient. Other equipment sold/rented by the petitioner is mechanical in nature, but still uses air pressure to operate. The exsufflation belt is worn just above the waist and, when expanded by pumping air into it, applies pressure below the diaphragm, forcing air out of the lungs, thus causing a low pressure in the lungs which results in air being moved into the lungs.

Parts of the equipment that are used in positive pressure devices are also used in the negative pressure devices. For instance, pumps and hoses can be used to provide positive pressure or create the vacuum necessary in the negative pressure devices dependent upon the application. In all cases, some part of the equipment is worn by the patient and some portion, such as a pump and regulator, is placed on a table or a cart nearby.

The principal issue raised by the petition was whether sales or use tax should apply to the sale or rental of respiratory equipment that provides a flow of air/oxygen to the patient through the application of negative pressure. Should those sales be allowed as exempt sales of oxygen delivery systems under Revenue and Taxation Code Section 6369.5?

LIFECARE SERVICES, INC. (Contd.)

The Board concluded that respiratory equipment that induces air into the lungs of a patient, through the application of pressure to the chest area, qualifies for the exemption as oxygen delivery systems as is provided for in Revenue and Taxation Code Section 6369.5, regardless of whether the pressure applied is negative pressure or positive pressure. Included in the granting of exemption were: the exsufflation belt, the iron lung, the chest shell, the pulmo wrap, and the pumps and regulators necessary for the operation of the listed equipment. On the other hand rocking beds were not included in the exemption.

A second issue was whether the respiratory equipment qualified as nontaxable prosthetic devices as defined in Sales and Use Tax Regulation 1591(b)(5). The Board concluded the respiratory equipment did not qualify for that exemption since the equipment was not designed to be fully worn on the person of the user.

The Board ordered the matter redetermined in accordance with this finding.

Done at Torrance, California, this 8th day of September, 1993.

Matthew K. Fong, Member
Ernest J. Dronenburg, Jr., Member
Windie Scott, Member
Attested by: Burton W. Oliver, Executive Director

MARVIN H. LINCOLN

Page paste-ups do not become an "ingredient or component" part of magazines that are ultimately produced, distributed and sold. The role of a person furnishing paste-ups in the production and sale of a magazine is more like that of a contributing author and an editor with respect to the concept and like that of a producer of finished art work sold and used by someone else to actually produce the magazine as far as the actual paste-up is concerned. The sale of a paste-up is a sale of finished art which was used and did not become an ingredient part of the magazine periodical produced from the art.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of MARVIN H. LINCOLN & WILLIAM A. NEW dba NEW LINK ENTERPRISES *for Redetermination of Sales Tax*

Appearances:

For Petitioners:	Mr. Stanley Stone Attorney at Law
For Staff:	Mr. Robert H. Anderson Tax Counsel

MEMORANDUM OPINION

This petition was filed by William O. New pursuant to a sales tax deficiency determination in the amount of $2,330.00 for the period of February 1, 1966 through October 31, 1966.

MARVIN H. LINCOLN (Contd.)

Petitioners make up a two-man partnership business that was engaged in producing motion picture stills and negatives along with other activities, some of which are indirectly in issue as far as their description is concerned.

The real issue presented by the petition is whether the gross receipts, amounting to $58,250, from the sales of page paste-ups used to manufacture printing aids which are, in turn, used to print magazines, are exempt under section 6362 of the Sales and Use Tax Law and ruling 50 (now regulation 1590) as sales of periodicals or sales of ingredients or components of periodicals, or whether they are receipts from the sale of finished art.

A page paste-up is a large single sheet of heavy paper on which printed copy and photographs are carefully placed and pasted. The size of the copy and photographs is in proportion to what is desired when the page paste-up is reduced, by photography, to the actual size of the page in the magazine to be reproduced. Arrangement of photographs and copy, therefore, becomes the format of what is to be produced. Inextricable with the physical property produced is the intangible idea of what is intended to be conveyed to the ultimate readers.

Petitioners created the idea for the magazine content and format and produced it in the form of page paste-ups. The entire package was then sold to Golden State News, a national distributor of magazines and paperback books. The sale was for a lump-sum price and Golden State News received all right, title and interest in the paste-ups, including the intangible idea they conveyed.

Golden State News Company had the page paste-ups photographed, and from the negatives produced a printing aid used to print the finished pages that were assembled, cut and bound into magazines. Petitioners had nothing to do with the printing, distribution or sale of the magazines, and did not share in the proceeds from the sales made by Golden State News Company or by those who sold them at retail, regardless of how many were printed and sold.

Petitioners contend that the sale of the paste-ups was a sale of a ‘‘concept’’ of a publication and was, therefore, the sale of a publication which was a periodical and under section 6362 and ruling 50, the gross receipts from the sale of the paste-ups are exempt from sales tax.

This argument must be considered in the light of the well-established rule that exemptions, such as the one we are herewith concerned, are to be strictly construed against the taxpayer. (*Good Humor Co.* v. *State Board of Equalization* (1957) 152 Cal.App.2d 879.)

Section 6362, subdivision (a) provides:

> ‘‘(a) There are exempted from the taxes imposed by this part, the gross receipts from the sale of, and the storage, use, or other consumption in this state, of tangible personal property which becomes an ingredient or component part of any newspaper or periodical regularly issued at average intervals not exceeding three months and any such newspaper or periodical.’’

MARVIN H. LINCOLN (Contd.)

Regulation 1590 (formerly ruling 50) contains the test of what constitutes a periodical, as far as content and frequency of publication are concerned. Subsection (3) of regulation 1590 contains a provision which, though adopted in the form of a regulation rather recently, i.e., April 8, 1970, describes a view which we have consistently taken:

> ''The term 'ingredient or component part of a newspaper or periodical' includes only those items that become physically incorporated into the publication and not those which are merely consumed or used in the production of the publication. A photograph, for example, does not become an ingredient or component part of a newspaper or periodical merely because the image of the photograph is reproduced in the publication.''

It is readily apparent that the theory underlying the exemption presupposes that the publisher who sells the periodical is going to produce, publish and sell more than only one copy of the periodical. Petitioner sold only one copy of each page paste-up.

In the strict sense of the word, the tangible personal property sold by the petitioner was not, in and of itself, a magazine, and for that reason it cannot be deemed to be a periodical, as the term is used under section 6362 and regulation 1590.

Clearly, the page paste-ups did not become an ''ingredient or component'' part of the magazines that were ultimately produced, distributed and sold by Golden State News Company, and therefore, and sale of them does not qualify for the exemption under section 6362 and regulation 1590.

Petitioner's role in the production and sale of the magazines is more like that of a contributing author and an editor, as far as the conception for contents is concerned, and like that of a producer of finished art work sold and used by someone else to actually produce the magazines, as far as the actual page paste-ups are concerned.

Petitioners contend they sold the concept of a magazine. While it may be true that petitioners sold an intangible concept of a magazine, *they also sold tangible personal property,* which was not a magazine, but was property used as a manufacturing aid to actually produce magazines. The true object of the sale agreement wherein the page paste-ups were sold to Golden State News Company was the acquisition of the paste-ups themselves, for without them no magazine could have been produced. Thus, it is concluded that the sale of the paste-ups was a sale of finished art which was used, and which did not become an ingredient or component part of the magazine periodical produced from the finished art.

For the reasons expressed in this opinion, the board rejects petitioners' contention that they sold periodicals, and concludes that the retail sales of the page paste-ups to Golden State News Company were taxable retail sales of tangible personal property.

MARVIN H. LINCOLN (Contd.)

Done at Sacramento, California, this 5th day of November, 1970.

George R. Reilly, Chairman
John W. Lynch, Member
Paul R. Leake, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

| LONG BEACH CONTAINER TERMINAL, INC.

There is a difference in the constitutional nexus requirements for purposes of liability in collection for use tax owed by a customer and for purposes of direct liability for sales tax. Nexus, for purposes of sales tax liability, requires that a California office of the seller participate in the sale. Establishment by a vendor of a temporary construction site in California, solely for the purpose of installing the property sold pursuant to contract entered into prior to the establishment of the site, does not create the required constitutional nexus for imposition of a sales tax.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

DECISION OF THE BOARD

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of LONG BEACH CONTAINER TERMINAL INC. *Petitioner*

Appearances:

For Petitioner:	Bernard Mintz Certified Public Accountant
	Eric P. Lerner Certified Public Accountant
	William Vande Wettering Certified Public Accountant
For Business Taxes Appeals Review Section:	Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Robert Nunes Deputy Director
	John Waid Staff Counsel

This Decision deals with the application of tax to container cranes purchased from an out-of-state retailer for use in California. Tax was asserted in a Notice of Determination issued June 13, 1991, which was based on an audit covering the period from January 1, 1988 through March 31, 1990. The Board heard the matter

LONG BEACH CONTAINER TERMINAL, INC. (Contd.)

at the regular meeting of the Board on September 8, 1993, in Torrance, California and denied the petition at the regular meeting of the Board on June 30, 1994, in Sacramento, California.

Petitioner purchased the container cranes from an Italian corporation. The contract provided that the price included all taxes, however, the seller was not authorized by the Board to collect use tax, and in fact no tax was paid to the Board. The seller was obligated under the contract to erect (install) the cranes at petitioner's Long Beach location and maintained a construction site there for that purpose during the installation. The customs documents consigned the cranes to the seller at the construction site and the seller made all arrangements for processing the cranes through customs. The seller hired local subcontractors to perform some portions of the installation work.

The issue is whether the transaction was subject to sales tax or to use tax. If sales tax was due, the Italian corporation would be liable for the tax, and petitioner would have no liability. If use tax was due, petitioner would be liable for the tax because it did not hold a receipt for the tax from a person authorized by the Board to collect the tax.

Subdivision (a) (2) of Sales and Use Tax Regulation 1620, as it read at the time of this sale, provided:

> "(A) Sales tax applies when the order for the property is sent by the purchaser to, or delivery of the property is made by, any local branch, office, outlet or other place of business of the retailer in this state . . . . and the sale occurs in this state. . . . Participation in the transaction in any way by the local office, branch, outlet or other place of business is sufficient to sustain the tax.
>
> "(B) Sales tax does not apply when the order is sent by the purchaser directly to the retailer at a point outside this state, or to an agent of the retailer in this state, and the property is shipped to the purchaser, pursuant to the contract of sale, from a point outside this state directly to the purchaser in this state, or the retailer's agent in this state for delivery to the purchaser in this state, provided there is no participation whatever in the transaction by any local branch, office, outlet or other place of business of the retailer . . . . "

These provisions are derived directly from the decision of the United States Supreme Court in *Norton* v. *Illinois,* 340 U.S. 534. For sales tax to apply, there are two conditions: (1) the sale (title passage) must take place in California and (2) a California office of the retailer must participate in the transaction.

There was contradictory evidence as to where title passed. If title passed outside California, sales tax could not apply and the buyer would without question be liable for use tax. If title passed inside California, it is still necessary for the second condition, a California office, to have been met.

The seller maintained no permanent office in this state. The temporary construction site in this state was established after the parties entered into the contract in question, and was solely for the purpose of installing the cranes

LONG BEACH CONTAINER TERMINAL, INC. (Contd.)

pursuant to that contract. This construction site was on real property controlled by petitioner, and the seller was there only as a result of a license to use for installation granted by petitioner.

Given the above, we conclude that the sale (title passage) did occur in California, but that the second requirement, of a California office, was not met. There is a difference in the constitutional nexus requirements for purposes of liability for collection of use tax owed by a customer and for purposes of direct liability for sales tax. Nexus, for purposes of sales tax liability, required that a California office of the seller participate in the sale. We conclude that establishment by a vendor of a temporary construction site in California, solely for the purpose of installing the property sold pursuant to a contract entered into prior to the establishment of the site, does not create the required constitutional nexus for imposition of a sales tax.

Adopted at Sacramento, California this 17th day of November, 1994.

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Attested by: Burton W. Oliver, Executive Director

MATSON NAVIGATION COMPANY

Cargo containers brought empty from Japan to California for subsequent use in carrying cargo did not enter the state while being used in foreign commerce. A taxable use occurred in California when they were readied and placed in standby status awaiting cargo for an outbound trip.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of MATSON NAVIGATION COMPANY *for Redetermination of Use Tax*

Appearances:

For Petitioner:	Hart H. Spiegel Attorney at Law
	Robert C. Livsey Attorney at Law
For Staff:	Robert H. Anderson Tax Counsel

MEMORANDUM OPINION

This petition was filed to protest the assertion of use tax on cargo containers that were purchased in Japan and shipped empty to the State of California where they were unloaded and placed in standby condition awaiting cargo that was to be shipped from California to Japan and other Far East countries.

MATSON NAVIGATION COMPANY (Contd.)

The issue presented by this petition is whether the cargo containers were being used in foreign commerce by reason of the fact that they were placed aboard ship, in Japan, for transportation to California, without any cargo for import to the United States.

Matson Navigation Company is a corporation and is a wholly owned subsidiary of Alexander & Baldwin. The Matson ships carry cargo imported to and exported from the United States. One of their stops is Japan where there has been an imbalance of export and import shipments. Exports from the United States exceed imports from Japan by about 25 percent so that for every 100 containers leaving California full of cargo only 75 come back with cargo. The remainder return empty.

Matson Navigation Company purchased new containers from Japanese suppliers in Japan, and because of the imbalance of trade some of the new containers were shipped to California empty. They were transported on board Matson ships, and after arriving in California they were unloaded and made available for use in exporting goods to Japan.

Counsel for the staff contends that the first use made of the new containers that were shipped, empty, to California was in California before they were actually placed in foreign commerce use.

Counsel for the petitioner contends that the containers, even though empty, were placed in the flow of commerce, and were therefore being used in foreign commerce when they were placed on board ship to be sent to California, where they were to be loaded with cargo for the return trip to Japan.

If we were to conclude, which we do not, that the new empty containers leaving Japan for the first time were, in fact, in foreign commerce use by reason of their being transported to the United States for cargo loading destined for Japan then there would be no use tax liability because of constitutional prohibition.

Counsel for Matson Navigation Company argues that the export-import of goods between the United States and Japan is like a large invisible belt constantly moving between the two countries and cargo is placed on the belt, in containers, in each country. Thus, when the new empty containers never before having been loaded with cargo, are placed on the so-called belt in Japan, they are in the flow of commerce and even though empty are being used in foreign commerce before ever entering the United States.

Sales and Use Tax Regulation 1620, subsection (b)(1) provides as follows:

> ''Use tax applies with respect to any property purchased for storage, use or other consumption in this state the sale of which is exempt from sales tax under this regulation, except property held or stored in this state for sale in the regular course of business or subsequent use solely outside this state, and *except property purchased for use in interstate or foreign commerce, placed in use in interstate or foreign commerce prior to its entry into this state, and thereafter used continuously in interstate or foreign commerce."* (Italic added.)

The containers were not instruments used in foreign commerce until they were first filled with cargo to be exported or imported as the circumstances required.

MATSON NAVIGATION COMPANY (Contd.)

The fact that the empty containers were being transported to California to make possible outbound service does not dictate the conclusion that they were instruments of commerce when they were en route to California.

The first use of the containers was in California when they were readied and placed in standby status awaiting cargo for an outbound trip to Japan. The first consumptive use in California constituted a taxable event.

The tax imposed by Revenue and Taxation Code Sections 6201 and 6202 is on the use of goods in California. The import-export clause of the Federal Constitution does not prohibit application of use tax with respect to the containers. (*Sugarman* v. *State Board of Equalization,* 51 Cal.2d 361 (1958).) Petitioner does not argue that point.

The effect of the commerce clause was considered in *Southern Pacific Co.* v. *Gallagher,* 306 U.S. 167 (1939). It was there held that use tax applied with respect to tangible personal property purchased outside of California by a railroad company, brought here by the company, and temporarily stored pending its intended installation or use as part of the interstate transportation facilities. The Court said that there was a taxable moment when the property had reached the end of its interstate transportation and had not begun to be consumed in interstate operation.

Petitioner cites *Bingaman* v. *Golden Eagle Western Lines, Inc.,* 287 U.S. 626 (1936) in support of its position that the empty containers were used in foreign commerce as soon as they were placed aboard ship in Japan. The *Bingaman* case held that use tax could not be applied to the use of gasoline purchased and placed in the fuel tanks of buses outside the taxing state, when the buses traveled entirely in interstate commerce. The gasoline, however, is distinguishable from the empty containers that concern us here, since the gasoline was essential to the propulsion of the buses in interstate commerce and its use for that purpose commenced outside the taxing state.

Petitioner also cites the case of *Atchison, Topeka and Santa Fe Railway* v. *State Board of Equalization,* 131 Cal.App.2d 677 (1955). There, a railroad company purchased repair parts for train control equipment and brought the parts into California where they were permanently affixed on a locomotive which then traveled in interstate commerce. As in the *Southern Pacific* case, *supra,* the court found a taxable use in California before the parts were used in interstate commerce.

The point made by petitioner is that the court regarded the use of the parts in interstate commerce as commencing when they were affixed to the locomotive, even though their only operational use was over a short stretch of track in Iowa and Illinois which was equipped to operate in conjunction with the control equipment on the locomotive. Petitioner compares its empty, nonoperational containers placed aboard ship with the nonoperational parts placed on the locomotive, with respect to the question of when the use in commerce commenced. The locomotive parts, however, were permanently affixed to and became component parts of the locomotive. They were therefore as much an

MATSON NAVIGATION COMPANY (Contd.)

instrumentality of interstate commerce as the locomotive itself. The empty containers were not permanently affixed to the ship on which they were carried so as to become component parts of the ship.

In our view the empty containers placed aboard ship in Japan and brought to California were not then used in commerce any more than the railroad properties in the *Southern Pacific* case and the *Atchison, Topeka and Santa Fe* case were used in commerce when they were placed aboard trains and brought to California. The empty containers were brought here so that they could subsequently be used in carrying cargo. Since they did not enter the state while being used in foreign commerce, a taxable use occurred in California prior to the first use in foreign commerce.

For the reasons expressed in this opinion, the matter is redetermined without adjustment.

Done at Sacramento, California, this 29th day of March, 1972.

John W. Lynch, Chairman
Richard Nevins, Member
George R. Reilly, Member
William M. Bennett, Member
Attested by: W. W. Dunlop, Executive Secretary

MICRO REPRODUCTION SERVICES, INC.

The petitioner's customers were interested in securing the end product of petitioner's services, photocopies, for their use. The securing and field copying of the original record were activities. The performance of which was required in order to fulfill the contract for the production and delivery of the photocopies. These activities were properly considered to be services that were apart of the production and sale of the photocopies.

The charges were not for the transmission of information. While the customers may have desired the photocopies of the records to obtain information recorded thereon, it was not information which was an original composition of the petitioner. Petitioner's work did not result in the creation of any information. Petitioner's activity is indistinguishable from the work of a book printer.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of MICRO REPRODUCTION SERVICES, INC.

Appearances:

For Petitioner: Mr. Stanley Blaine Worthington
President

For Staff: Mr. W. E. Burkett
Tax Counsel

MICRO REPRODUCTION SERVICES, INC. (Contd.)

MEMORANDUM OPINION

This opinion considers the merit of a protested final determination for sales and use taxes in the amount of $9,315, plus statutory interest determined against petitioner for the period January 1, 1966, to June 30, 1967.

Petitioner is a California corporation engaged in the business of reproducing and delivering photocopies of medical records. Its brochure describes its activity as a photocopy service.

Petitioner's customers are primarily attorneys and insurance companies who desire copies of original medical records for their own use or for use in court. Petitioner also reproduces and delivers photocopies of records for hospitals who are authorized to respond to a subpoena duces tecum by submitting micro reproductions of the records in lieu of producing the original records.

The production and delivery of the photocopy is carried out in the following manner:

1. Petitioner receives a written or telephone order from the customer generally identifying the records of which copies are desired.

2. Its representative contacts the custodian of the records and secures an appointment to micro reproduce the records. This sometimes involves additional work in locating the custodian of the records.

3. A field representative of petitioner then goes to the location of the records and micro reproduces those records considered necessary to fill the customer's order. This may involve an element of identification in selecting the particular portion of the records ordered by the customer.

4. The microfilm is then delivered to a central facility for processing and reproduction of full size photocopies.

5. The reproduced photocopies are then hand delivered or mailed to the customer.

Petitioner makes a basic charge for processing the order and arranging for the copying, an additional charge for field services and a separate unit charge for each reproduced copy delivered to the customer. Tax has been paid on the separately stated unit charge for each reproduced copy, but no taxes have been paid on the balance of the charges. It is these amounts that make up the protested measure of tax.

The question presented is whether the activity performed by petitioner, or any portion thereof, constitutes a sale of tangible personal property or is an exempt sale of services. Sales of services are not subject to tax even though the person rendering the services may incidentally use property in the performance thereof (sales and use taxes ruling 1, (Admin. Code 1901)). Conversely, charges for the production of tangible personal property are subject to tax without deduction for any cost or expense incurred in producing the property or ''any services that are a part of the sale'' (Rev. & Tax. Code § 6012).

Petitioner's principal contention is that its charges should be classified as sales of services because its work consists primarily of the professional service of locating, identifying, and selecting the records for the field exposure or

MICRO REPRODUCTION SERVICES, INC. (Contd.)

''shooting'' of the microfilm. However, it is not the predominance of services that determines the classification of the charge because the production of property often consists primarily of the performance of skilled services. This was pointed out in the following terms by the court in *People* v. *Grazer* (1956) 138 Cal.App.2d 274, which reviewed the application of the sales tax to charges for the production of X-rays and accompanying reports:

> ''To be sure, the raw materials consumed in producing that which he ordered may have cost the laboratory only a small part of the charge made. The expense of the producer of the pictures is almost entirely the cost of the skilled services of the radiologist and the technicians and the use of equipment which is generally quite costly. But the price charged for all taxable transfers is more often than not largely a charge for services rendered in connection with the tangible object transferred.''

Rather, the test is whether the customer desired to acquire the services or the product of the services for his use. (*People* v. *Grazer*, supra; *Albers* v. *State Board of Equalization* (1965) 237 Cal.App.2d 494.)

In the *Albers* case, a draftsman's charge for preparing a drawing from detail provided by the customer was held to result in the production and sale of property because the customer desired the end product of the draftsman's services, the drawing, for his use, and not merely the services of the draftsman. In the words of the court:

> ''He (Albers) simply applied his ability to the details supplied by the customer for the purpose of putting such details down on paper and thereby producing a drawing for use by the customer. In other words, the customer was purchasing the detailed drawing for his use, he was not purchasing the design or specifications pictured in the drawing.''

Hence, the acquisition of the finished article was considered to be the true object of the contract.

Similarly, petitioner's customers did not desire to acquire its services for any independent purpose. Rather, they were interested in securing the end product of the services, the photocopy, for their use. The securing and field copying of the original record were activities, the performance of which was required in order to fulfill the contract for the production and delivery of the photocopy. We, therefore, believe that these activities were properly considered to be services that were a part of the production and sale of the photocopy. The photocopy is undeniably tangible personal property. (Rev. & Tax. Code § 6016.)

It is also claimed that the charges were made for the transmission of information and not for property, While the customers may have, in many instances, desired the photocopies of the records to obtain information recorded thereon, it was not information which was an original composition by this taxpayer; such as is an architect's plan, a writer's manuscript, or a lawyer's brief. Petitioner's work did not result in the *creation* of any information. It merely reproduced material originally recorded or documented by the owner of the records. In this respect, its activity is indistinguishable from the work of a book printer or any other person reproducing and selling property from which

MICRO REPRODUCTION SERVICES, INC. (Contd.)

information may be obtained. Such an activity is classified as a sale of tangible personal property by the provisions of Revenue and Taxation Code section 6006, which defines a sale to include:

"(f) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, or of any publication."

We conclude that the claim that the taxes were erroneously determined is without merit.

Done at Sacramento, California, this 25th day of March 1969.

George R. Reilly, Chairman
Paul R. Leake, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

JOHN CHRIS MOGANNAM

Revenue and Taxation Code Section 6363 may be applied to exempt meals provided by a third party hired by the school to operate cafeteria on the school's premises. The exemption will apply when the facts show that the school was in fact furnishing the meals to the students by hiring a third party to sell the meals using the school's facilities.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of JOHN CHRIS MOGANNAM

Appearances:

For Petitioner:	Mr. John Chris Mogannam
For Sales and Use Tax Department:	Mr. Gary J. Jugum Assistant Chief Counsel Mr. Warren Astleford *Senior Tax Counsel*
For Appeals Section:	Ms. Susan M. Wengel Senior Tax Counsel

This opinion considers the merits of the petition for redetermination under the Sales and Use Tax Law for the period January 1, 1993, through December 31, 1995. Petitioner operated a cafeteria on the premises of a private school, St. Francis High School in Sacramento, California. He operated the cafeteria and paid rent to the school. He used the cooking equipment and serving facilities owned by the school and served lunches to the students in the school's multipurpose room during the lunch hours. The school used the room for other purposes such as sporting events, plays, and other school activities during the

JOHN CHRIS MOGANNAM (Contd.)

remainder of the school day. The only sales in question are the sales in which the students directly paid petitioner for their lunches.

The issue presented in this petition is whether Revenue and Taxation Code section 6363 exempts the sales of meals by petitioner to the students. This statute states, in pertinent part, that there are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage, use, or other consumption in this state of, meals and food products for human consumption furnished or served to the students of a school by public or private schools.

OPINION

We conclude that petitioner's sales to the students do qualify for exemption under Revenue and Taxation Code section 6363. We also find that the school was in fact furnishing the meals to the students by hiring petitioner to sell the meals to the students at the school's facilities. If not for the permission of the school and the use of the school's facilities, including its fixtures and equipment, the meals could not have been furnished to the students.

Our conclusion was largely based upon the following facts which we determined as necessary for school meals to qualify for the Revenue and Taxation Code section 6363 exemption:

1. The facilities used by the operator to serve the lunches to the students is used by the school for other purposes such as sporting events and other school activities during the remainder of the school day.

2. The fixtures and equipment used by the operator are owned and maintained by the school.

3. The students purchasing the meals cannot distinguish the operator from the employees of the school.

We thus conclude that the petition for redetermination should be granted.

Done at Sacramento, California, this 10th day of August, 2000.

Dean Andal, Member

Claude Parrish, Member

Marcy Jo Mandel*

* For Kathleen Connell, per Government Code section 7.9.

NATIONAL STEEL & SHIPBUILDING COMPANY

Petitioner/claimant is an operational shipyard in San Diego, California which builds, converts and repairs ships for the United States Navy. Its contracts with the U.S. Navy are fixed-price contracts and contain the Payments clause of Department of Defense Federal Acquisition Regulation Supplement (DFARS) 252.217–7007. This clause references DFARS 252.217–7006. The issue presented was whether, when read together, these two sections pass title of overhead materials to the U.S. Navy upon receipt of a progress payment. Petitioner/claimant's overhead materials consist of nuts, bolts, paint and office supplies.

NATIONAL STEEL & SHIPBUILDING COMPANY (Contd.)

The Board concluded that when petitioner/claimant is reimbursed by the government for an item including overhead materials, that the government retains title to that item. The progress payments made to petitioner/claimant under DFARS 252.217–7007 includes costs for both direct and overhead materials which are to be used in repairing a ship. Consequently, these two clauses apply to overhead materials and title to these overhead materials passes on payment of the progress payments.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination and the Claims for Refund of NATIONAL STEEL AND SHIPBUILDING COMPANY *under the Sales and Use Tax Law*

Appearances:

For Petitioner:	Mr. Lane L. McVey Attorney
	James B. Euphrat Tax Manager
	Gail H. Morse Attorney
For Sales and Use Tax Department:	Mr. Gary J. Jugum Assistant Chief Counsel
	Ms. Janice Thurston Senior Tax Counsel
For Appeals Section:	Ms. Susan M. Wengel Senior Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of the petition for redetermination and the claims for refund under the Sales and Use Tax Law for the periods January 1, 1992 through June 30, 1995 (-010); January 1, 1985 through June 30, 1991 (-001); and January 1, 1992 through June 30, 1995 (-006). Petitioner/claimant, corporation, is an operational shipyard in San Diego, California which builds, converts and repair ships for the United States Navy. Its contracts with the U. S. Navy are fixed-price contracts and contain the Payments clause of Department of Defense Federal Acquisition Regulation Supplement (DFARS) 252.217–7106 which has now been renumbered to DFARS 252.217–7007. Subdivision (f) of this clause provides that:

> ''all materials, equipment, or any other property or work in process covered by the progress payments made by the Government, upon the making of those progress payments, shall become the sole property of the Government, and are subject to the provisions of the Title clause of the Master Agreement.''

NATIONAL STEEL & SHIPBUILDING COMPANY (Contd.)

The Title clause referred to in the above section is found in DFARS 252.217–7006, formerly numbered as DFARS 252.217–7105. This provision states that:

> (a) Unless otherwise provided, title to all materials and equipment to be incorporated in a vessel in the performance of a job order shall vest in the government upon delivery at the location specified for the performance of the work.
>
> (b) Upon completion of the job order, or with the approval of the Contracting Officer during performance of the job order, all Contractor-furnished materials and equipment not incorporated in, or placed on, any vessel, shall become the property of the Contractor unless the Government has reimbursed the Contractor of the cost of the materials and equipment.
>
> (c) The vessel, its equipment, movable stores, cargo, or other ship's materials shall not be considered Government-furnished property.

The issue presented in this petition and related claims for refund is whether, when read together, these two sections pass title of overhead materials to the U. S. Navy upon receipt of a progress payment. Petitioner/claimant's overhead materials consist of nuts, bolts, paint and office supplies.

The Sales and Use Tax Department has taken the position that DFARS 252.217–7006 is limited to materials and equipment that are actually incorporated in or placed upon the vessel.

OPINION

We conclude that when petitioner/claimant is reimbursed by the government for an item including overhead materials, the government retains title to that item. The progress payments made to petitioner/claimant under DFARS 252.217–7007 include costs for both direct and overhead materials which are to be used in repairing a ship. Consequently, the two DFARS clauses apply to overhead materials and title to these overhead materials passes on payment of the progress payments. See *Aerospace Corporation* v. *State Board of Equalization* (1990) 218 Cal.App.3d 1300.

We thus conclude that the petition for redetermination and the claims for refund should be granted.

Done at Sacramento, California, this 19th day of November, 1999.

Dean F. Andal, Member

Claude Parrish, Member

John Chiang, Member

Marcy Jo Mandel, Member*

* For Kathleen Connell, per Government Code section 7.9.

NICKOLS CONCRETE CO., INC.

A hiring of personal property occurs when the owner gives another temporary possession and use of the property for a consideration with the provision that the property will be returned to the owner at a future date. Property hired with an operator may be possessed and used by exercising fundamental control over the operator. However, the continued exercise of control by the owner over the details of operating the property indicates the existence of an independent contract for the operation of the property.

In determining the nature of the taxpayer's agreements with its customers, the labels used by the parties are not necessarily controlling, and consideration should be given to the circumstances under which the contract was made as well as the parties' conduct while the work was being performed. The right to hire and fire the equipment operator is an important consideration in deciding who exercised fundamental control over the operation of the equipment.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of NICKOLS CONCRETE CO., INC. *Petitioner*

Appearances:

For petitioner: Mr. James R. Moore, of the law firm of Souther, Spaulding, Kinsey, Williamson & Schwabe.

For staff: Mr. W. E. Burkett
Tax Counsel

MEMORANDUM OPINION

The petitioner has protested determination of deficiencies for sales and use taxes of $11,735.05, under account No. SR DHA 28 100082 for the period 10/1/67 to 2/28/70, and additional sales and use taxes of $24,930 determined for operations conducted under account No. SY AC 22 628525.

The protested taxes were measured by receipts received by the taxpayer under contracts entered into with the J. H. Pomeroy & Co. (Pomeroy), The Morrision-Knudsen Company, Inc. (Morrison-Knudsen), and the City of Los Angeles Department of Water and Power (City).

Pursuant to separate agreements the taxpayer contracted to sell dry concrete and certain other mixing supplies to Pomeroy and Morrison-Knudsen f.o.b. jobsite, to rent the equipment required for mixing and to furnish the labor services required to produce and deliver the ready-mix concrete.

The purchase orders issued by the contractors for the concrete each recited that the operation and mixing of the concrete was to be performed in such manner as may be directed by the purchaser.

The taxpayer declared tax on the amounts charged for the concrete materials and for the labor services required to operate the concrete-mixing equipment. It claimed an exemption for the separately stated amounts billed for the rental of the concrete-mixing equipment. The staff recommended a deficiency measured by the charges for equipment rental on the basis that the amount was merely

NICKOLS CONCRETE CO., INC. (Contd.)

reimbursement for an item of costs and expense incurred by the taxpayer in the course of producing and selling ready-mix concrete.

The two contracts for the rental of the ready-mix equipment contained the following common provisions:

1. The batch plant was to be erected and removed at the sole cost and expense of lessor (petitioner).

2. The lessor was to pay all expenses of operating and maintaining the batch plant.

3. The lessor was to keep the plant insured at its own cost and pay all taxes assessed with respect to the plant.

4. The lessor was to save and hold the lessee harmless from any obligation or liability in connection with operation of the batch plant other than liability arising from the sole negligence of lessee or its authorized agency.

5. The rental was for a fixed term at a specified monthly rental with an option to extend the lease on a monthly basis for an additional sum.

6. The lease contract was associated with an agreement for the sale of material and a breach of the agreement for the sale of materials was specified to be a breach of the lease agreement.

7. The lease agreement was not assignable without the prior written consent of the other party.

The contract with the City of Los Angeles provided separate lump-sum charges for the installation and removal of the concrete batch plant and for the monthly repair, maintenance and other fixed charges relating to the batch plant. It also included specific amounts for the services of operating the plant equipment.

The charge for the services of operating the batch plant, including all labor costs and profit was a lump-sum amount ‘‘per plant shift’’ with provision for overtime.

The contract contained provisions requiring the granting of employment preferences to residents of the City of Los Angeles and qualification of workmen to be employed by the taxpayer in performing the contract.

The taxpayer agreed to save harmless and indemnify the City of Los Angeles for any damage, loss or injury to persons or property of others on or adjacent to the worksite resulting directly or indirectly:

> ‘‘From the work of the Contractor [taxpayer] or his subcontractors, in the performance of this contract, or from his or their failure to comply with any of the provisions of this contract.’’

The taxpayer was required to pay all applicable manufacturing, sales, use or excise taxes and all taxes assessed against his equipment or property used in connection with the work and to bear all expenses of all factory tests on all equipment furnished by it.

The City of Los Angeles had the right of inspection of material for conformance with specifications and its engineer was given the authority to give the orders, lines, grades, and directions, as provided in the specifications; to

determine the adequacy of the contractor's methods, plant, and appurtenances; to determine within the limitations of the specifications, the amount, quality, acceptability, and fitness of the various kinds of work and materials to be paid for.

The agreement of the parties further provided:

"If the Contractor, at any time, fails to comply with these specifications in any way, the Engineer shall have the power to order all further work stopped. Such 'Stop Work' order shall be in writing only from the Engineer, and shall allow the Contractor three working days in which to comply with its demands. Any such work on which 'Stop Work' order is issued shall be corrected to the entire satisfaction of the Engineer.

"Any such interruption shall not act to relieve the Contractor of his obligation to complete the work. . . ."

The staff concluded that all of the charges rendered pursuant to the contract were for the cost, expenses and profit incurred in fabricating customer-owned property, and therefore includible in gross receipts. The taxpayer contends that all amounts billed to the City of Los Angeles was either for rental of equipment or exempt labor service.

In support of its contention, the taxpayer has offered the affidavit of Louis E. Nickols, the president of taxpayer corporation which attests that the City of Los Angeles has at times furnished workmen to operate certain of the batch plant equipment and provided certain supervisory personnel. It is claimed that the taxpayer was back-charged for these services and that in practical effect the mixing operation was operated and controlled by the taxpayer.

THE MORRISON-KNUDSEN AND POMEROY CONTRACTS

In ruling on the gross receipts received from these contracts, we must decide whether the receipts were derived from the rental of property or were merely payment for the use of the equipment by the taxpayer in performing a processing or fabrication of ready-mix concrete. Since the taxpayer paid California sales tax reimbursement at the time it purchased the equipment and had not altered its form, a bona-fide rental of the property would be excluded from classification as a taxable leasing sale (Revenue and Taxation Code section 6006(g)(5)). On the other hand, if the ready-mix concrete were produced or fabricated by the taxpayer for the customer, the transaction would constitute a sale of the ready-mix concrete (R.T.C. section 6006(f)), and amounts received for the use of the equipment by the taxpayer would be includible in gross receipts as reimbursement for a cost or expense of the sale (Revenue and Taxation Code section 6012).

A hiring of personal property occurs when the owner gives another the temporary possession and use of the property for a consideration with the proviso that the property will be returned to the owner at a future date (Cal. Civil Code section 1925).

NICKOLS CONCRETE CO., INC. (Contd.)

Property hired with an operator may be possessed and used by exercising fundamental control over the operator (*Service Tank Lines* v. *Johnson*, 61 Cal.App.2d 67; *Lowell* v. *Harris*, 24 Cal.App.2d 70). However, the continued exercise of control by the owner over the details of operating the property indicates the existence of an independent contract for operation of the property (*Entremont* v. *Whitsell*, 13 Cal.290, 296).

In determining the nature of the taxpayer's agreements with its customers, the labels used by the parties are not necessarily controlling, and consideration should be given to the circumstances under which the contract was made as well as the parties' conduct while the work was being performed (*Automatic Canteen Co.* v. *State Board of Equalization*, 238 Cal.App.2d 372). Thus the entire agreements, the actual operation thereunder, and the related activities must all be examined to determine the true nature of the operations.

The right to hire and fire the equipment operator is an important consideration in deciding who exercised fundamental control over the operation of the equipment (*Entremont* v. *Whitsell*, 13 Cal.2d 290, 296, supra). Other factors considered by the courts to indicate that a purported ''rental'' agreement is in fact an independent contract are: the fact that the equipment owner maintains and supplies fuel to the machinery; that the equipment owner carries the operator on his employment records and payroll and carries compensation insurance on the operator; that the equipment owner assumes responsibility for damage to or caused by operation of the machinery; that the agreement would be illegal if construed to be a lease (see *Entremont* v. *Whitsell*, supra); and that the actual activities of the parties are substantially unchanged following substitution of a ''lease'' for a contract of hauling (see *Service Tank Lines* v. *Johnson*, supra).

Relating these guiding principles to the operations carried out under the Morrison-Knudsen and Pomeroy contracts, we find that in each instance the equipment was operated by workmen carried on the payroll of the taxpayer and in its general employment. The taxpayer was contractually responsible to the customer for any obligation incurred, or liability arising in connection with the operation of the batch plant, except liability arising from the sole negligence of the customer (form lessee). There is no evidence that would support a finding that the customer exercised fundamental control over the workmen. Indeed, it is virtually conceded that the customer did not exercise such control because the taxpayer has voluntarily declared and paid sales taxes on the amounts received for the labor services of the taxpayer's workmen in operating the batch plant equipment.

While the purchase orders recited that mixing operations were to be carried out as directed by the customers, this must be held to have been limited to instructions as to the results to be obtained, in view of the absence of a right to direct the details of accomplishing the work. This type of instruction is most indicative of an independent contract because fundamental control over the workmen and the means of accomplishing the result remains with the general employer (see *Billig* v. *Southern Pacific Co*., 189 Cal.477, 483).

NICKOLS CONCRETE CO., INC. (Contd.)

The taxpayer was also required to pay all expenses of operating and maintaining the batch plant equipment. This is contrary to the usual application of the law to rental property which requires the hirer to bear such expenses during the time he uses the property (see Cal.Civil Code section 1956).

Finally, we note that the form rental of equipment was an integral part of a contractual arrangement whereby the taxpayer provided the raw materials and created the end product using workmen in its general employment. The unitary nature of the agreements to sell raw materials and mix the concrete is demonstrated by the fact that a breach of one agreement was expressly made a breach of the other. Thus, in actual practice and legal effect, the arrangement was the same as if the taxpayer had contracted to produce and deliver the ready-mix concrete under a single agreement.

Viewing the whole agreement and the actual operations conducted thereunder, we conclude that the taxpayer did not effectively surrender possession of the property and that the payments cast in the form of rentals were in substance amounts received by the taxpayer for its use of the property to produce and deliver ready-mix concrete as an independent contractor.

THE CITY OF LOS ANGELES CONTRACT

We also conclude that the amounts received pursuant to the contract with the City were received for the production, fabrication or processing of ready-mix concrete, which constituted a sale within the meaning of Revenue and Taxation Code section 6006(b). While the taxpayer has strenuously argued that the agreement was a rental, the agreement was not cast in this form. The performances contracted for were to ‘‘INSTALL, MAINTAIN, OPERATE AND REMOVE A CONTRACTOR-OWNED CONCRETE BATCH PLANT’’.

Nor can we agree that the transaction was a rental or exempt service in actual operation.

The taxpayer was required by the terms of the contract to install, operate and maintain the property as an independent contractor utilizing its own workmen. It remained responsible for all of the actions of the workmen and it expressly agreed to indemnify and hold the City harmless for their activities in installing, operating and maintaining the property.

All of the amounts received relate to services, which were, in fact, performed by the taxpayer’s workmen. Since the services were not performed as employees of the City, they must have been performed on behalf of the taxpayer in the course of an independent contract for processing the concrete. One may not be both an employee and an independent contractor with respect to a single activity (*Automatic Canteen Co*. v. *State Board of Equalization*, 238 Cal.App.2d 348, 386).

NICKOLS CONCRETE CO., INC. (Contd.)

While the city had the right to exercise a high degree of control over the quality of the product, this extended only to the results of the work and not the means of obtaining it. This type of control has been held to be consistent with an independent contractor relationship (see discussion in *Automatic Canteen Co*. v. *State Board of Equalization,* supra).

With reference to the claim that the city has at times furnished workmen to supplement the taxpayer's work force, we note that the City would be authorized to take such action under the provisions of paragraph 10 of the contract if the city's engineer determined that there was a material breech of the ''progress of work clause'' found in paragraph 23. We do not regard such temporary action as operating to change the relationship of the parties and the obligation of the taxpayer under the contract. We understand that any amounts back charged to the taxpayer for labor services were not included in the audited measure of tax deficiency.

All of the services were steps or processes required to fabricate or produce ready-mix concrete and as such, changes for those services were properly includible in gross receipts (Revenue and Taxation Code, section 6006(b); sales and use taxes regulation 1526).

The determination, accordingly, is hereby redetermined without change.

Done at Sacramento, California, this 18th day of September, 1973.

William M. Bennett, Chairman

George R. Reilly, Member

John W. Lynch, Member

Richard Nevins, Member

Attested by: W. W. Dunlop, Executive Secretary

LEONARD EUGENE PERRY

The Memorandum Opinion of Leonard Eugene Perry dated May 13, 1999 holds that three products used as lagoon innoculants, called M.S. 2.5, LG 54 XTRA and M.S. 2.2, are exempted from tax pursuant to Revenue and Taxation Code section 6358(d) because they are a "fertilizer" to be applied to land the products of which are to be used as food for human consumption. The three products each meet the definition of "commercial fertilizer" as defined in the Food and Agriculture Code section 14522 as each product contains 5 percent or more of nitrogen, available phosphoric acid, or soluble potash, singly or collectively.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of LEONARD EUGENE PERRY

LEONARD EUGENE PERRY (Contd.)

Appearances:

For Petitioner:	Mr. Leonard Perry Mr. Kevin Kelley Attorney
For Appeals Section:	Ms. Susan Wengel Senior Tax Counsel
For Sales and Use Tax Department:	Ms. Janice Thurston Senior Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination in the amount of $4,886.87 in tax for the period January 1, 1993 through June 30, 1996. The Board heard this matter on March 17, 1999, in Sacramento, California.

Petitioner is a sole proprietor engaged in the business of supplying biological products and services to the dairy industry. In providing these products and services, petitioner purchased lagoon innoculants from an out-of-state vendor. These innoculants, more specifically three products called M.S. 2.5, LG 54 XTRA and M.S. 2.2, are substances used to break down solids and improve the fertilizer quality of manure. The innoculants are applied to manure wastewater held by dairy farmers in lagoons. After treatment the wastewater is drained off and used to irrigate fields. The solid matter at the bottom of the lagoon is dried and used by the dairy farmers as fertilizer on their fields.

The Sales and Use Tax Department (Department) concluded that petitioner was liable for use tax with respect to the lagoon innoculants that he applied to the dairy farmers' lagoons as part of his service business. The Department further concluded that whenever the lagoon innoculants were sold directly to the dairy farmers, the sale was subject to sales tax. It was the Department's position that the lagoon innoculants were purchased primarily as a catalyst to improve the quality of the cow manure as a fertilizer.

Petitioner contends that the written testimony of Thomas T. Yamashita, who has a Ph.D. in Plant Pathology from the University of California, Davis, supports the position that all three products are commercial fertilizers.

Revenue and Taxation Code section 6358(d) provides that there are exempted from the taxes imposed by this part, the gross receipts from the sale in this state of, and the storage, use, or other consumption in this state of fertilizer to be applied to land the products of which are to be used as food from human consumption. The California Code of Regulations, title 18, section 1588(b) provides the definition of the term ''fertilizer.'' This definition includes commercial fertilizers which are further defined in the Food and Agriculture Code section 14522. This statute provides that ''commercial fertilizer'' means any substance which contains 5 percent or more of nitrogen, available phosphoric acid, or soluble potash, singly or collectively, which is distributed in this state for promoting or stimulating plant growth.

LEONARD EUGENE PERRY (Contd.)

OPINION

Based on the written testimony of Thomas T. Yamashita, we conclude that M.S. 2.5, LG 54 XTRA and M.S. 2.2 by virtue of 5.5 percent levels of the essential elements, meet the definition of commercial fertilizer as set out in the Food and Agricultural Code. The petition is granted.

Done at Sacramento, California, this 13th day of May, 1999.

Johan Klehs, Chairman

Dean F. Andal, Member

Claude Parrish, Member

John Chiang, Member

Kathleen Connell, Member

PHOTO SCREEN SERVICE CO.

Exposed and developed photosensitive, gelatin-coated film, used in silk-screen stencil operations, is not a reproduction proof. The gelatin portion in the form of the desired design is a component part of the stencil used to print signs or posters.

Note: This case preceded the statutory exemption for reproduction proofs and for the most part the taxation of leases. It deals with an outdated version of Ruling 24 (now Regulation 1541). While the findings with respect to the gelatin coated film are still valid, the balance of the opinion regarding reproduction proof has been altered by subsequent statutory and regulatory changes.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of PHOTO SCREEN SERVICE CO. *for Redetermination of Sales Tax*

Appearances:

For Petitioner: John A. Pettis, Jr.
Attorney at Law

For Staff: Robert H. Anderson
Tax Counsel

MEMORANDUM OPINION

This petition is made pursuant to section 6561 of the Sales and Use Tax Law by Photo Screen Service Co. against a deficiency determination of sales tax in the amount of $5,623.36 for the period of October 1, 1962, to September 30, 1965.

The issue presented by this petition is whether gelatin coated film ready to be transferred to fine mesh silk constitutes a reproduction proof within the meaning of the term under ruling 24 relating to printing and related industries and as defined in Business Taxes General Bulletin 62-3, which contains an interpretation of reproduction proof as the term is used in ruling 24.

PHOTO SCREEN SERVICE CO. (Contd.)

Silk screen printing is a stencil process that forces ink through open meshes of a silk screen on which the desired pattern or design has been imposed, with those parts not to be printed stopped by an impermeable coating.

The manufacture of a silk screen, ready for printing, includes several steps. A layout is first drawn on paper. A transparency is made of the layout and it is photographed. The resulting negative is then exposed to a photo-sensitive gelatin coated plastic sheet. After the developing process the gelatin coating on the plastic sheet appears as the exact design on the negative. The gelatin design is then transferred to a fine mesh sheet of silk. In other words, the gelatin design is transferred from the plastic sheet to the fine mesh silk, thereby creating a stencil. The silk screen stencil is then tightly stretched over a wooden frame and is ready for use in printing.

The petitioner sells to a related firm known as Anderson Silk Screen Printing Company, Inc., the gelatin coated plastic sheet containing the desired design to be transferred to the fine mesh silk screen. The Anderson firm transfers the gelatin design to the silk and thereafter completes the manufacturing process. Sales to the Anderson firm were considered by the petitioner to be non-taxable transactions and no sales tax reimbursement was added to the sales price and no tax was reported and paid to the state.

Petitioner contends that the gelatin coated plastic sheet containing the design to be transferred to the silk screen is a reproduction proof under ruling 24 and as defined in bulletin 62-3.

Ruling 24 provides in part:

> The furnishing of reproduction or galley proofs for no additional charge does not render taxable the charge for typography or type composition. When, however, reproduction proofs are physically incorporated into a paste-up, ‘‘mechanical’’, or assembly, the cost of the reproduction proof including the cost of typography may not be deducted from the charge for the paste-up, ‘‘mechanical’’, or assembly in calculating the base on which the tax is computed.

Bulletin 62-3 defines reproduction proof to be:

> A ‘‘reproduction proof’’ is a direct proof, copy, likeness or photographic image of type set by any typesetting process and used exclusively for reproduction purposes. Tax does not apply for typesetting by any process notwithstanding the fact that a reproduction proof as defined herein, is delivered to a customer for no additional charge.

Proof is defined in the Reader’s Digest Great Encyclopedic Dictionary to mean, in the printing trade, a printed *trial* sheet showing the contents or condition of matter in type or of a plate or the like, with or without marked corrections. In engraving or etching a proof is a *trial*. In photography a proof is a *trial*.

The petitioner contends that the plastic sheet, gelatin-coated, in the form of the image or design to be transferred to the silk screen, is a reproduction proof pursuant to bulletin 62-3 because it is *a likeness of type set by a typesetting process and is used exclusively for reproduction purposes*. The petitioner

PHOTO SCREEN SERVICE CO. (Contd.)

implicitly assumes that the *sale* of a reproduction proof is not taxable. We need not discuss that point, however, since we do not believe that the item in question is a reproduction proof.

The petitioner has misconstrued the language of bulletin 62-3. The words ''used exclusively for reproduction purposes'' in bulletin 62-3 refer to the composed *type* and not the proof or trial sheet printed from that type. The fact that the item sold by petitioner is used for reproduction purposes is immaterial.

It is concluded, therefore, that the exposed and developed photosensitive, gelatin-coated film sold to the petitioner's related firm is not a reproduction proof. Rather, the gelatin portion in the form of the desired design is a component part of the silk screen stencil used to print signs or posters.

In this matter the Anderson Silk Screen Printing Company, Inc. is the printer, and under ruling 24 is the consumer of ''any properties purchased for use in the preparation of printed matter to be sold, provided title to such materials is retained by the printer.'' The Anderson firm retains title to the silk screen, including the gelatin-coated film it purchased from the petitioner. The sale of the gelatin-coated film to Anderson was, therefore, a retail sale of tangible personal property and was subject to tax.

For the reasons expressed in this opinion the Board has determined the tax as recommended by the staff, rejecting the petitioner's contention that the gelatin coated film is a reproduction proof and that the retail sale of it to Anderson Silk Screen Printing Company is not subject to sales tax.

Done at Sacramento, California, this 3rd day of October, 1967.

Paul R. Leake, Chairman
John W. Lynch, Member
George R. Reilly, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

PRATT NORTH PLAZA ASSOCIATES

An operator of a service enterprise is required to hold a seller's permit when, in any twelve month period, more than two sales for substantial amounts are made of tangible personal property used in the service enterprise, or a substantial number of sales for relatively small amounts are made of tangible personal property used in the service enterprise. The Board concluded that $400 is a substantial amount but declined to decide whether amounts less than $400 are substantial.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim of PRATT NORTH PLAZA ASSOCIATES AND NORTH PLAZA ASSOCIATES dba MAXIM'S DE PARIS *for Refund under the Sales and Use Tax Law*

PRATT NORTH PLAZA ASSOCIATES (Contd.)

Appearances:

For Claimant:	Mr. Paul Frederic Marx Attorney at Law
For Business Taxes Appeals Review Section:	Mr. Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Mr. David Levine Senior Staff Counsel

MEMORANDUM OPINION

This opinion considers the merits of a claim for refund in the amount of $57,018.58 in tax for the period October 1, 1989 to November 13, 1989. The Board heard and denied this claim on January 27, 1993.

Claimant's business consisted of a resort hotel, restaurant, and bar. Claimant sold the entire property for $25,950,000 on November 13, 1989. Claimant reported the gross receipts attributable to the sale of furniture and equipment in the restaurant and bar, but not the hotel.

During the twelve month period preceding the final sale, claimant made at least nineteen separate sales of hotel furniture and equipment to employees and others. Claimant refunded a total of $1,355 to nine employees on November 10, 1989, in an attempt to rescind nine sales to employees of mattresses and box springs made on November 15, 1988. The Appeals attorney ruled that these nine sales were not rescinded, noting that claimant unilaterally refunded the proceeds of sale, but the purchasers did not return the property sold.

The Department relying on *Hotel Del Coronado* v. *State Board of Equalization* (1971) 15 Cal.App.3d 612 and Sales and Use Tax Regulation 1595(a)(4)[1], concluded that the sales made were sufficient in number, scope, and character to require claimant to hold a seller's permit for the purposes of selling its hotel fixtures and equipment. Tax was determined on the final sale of the hotel's furniture and equipment. Claimant paid the tax under protest and filed a claim for refund.

Claimant asserts that the sales made were incidental to the hotel service business and argues that, although these sales satisfy the three sale rule set forth in Regulation 1595(a)(4)(A), they were not ''substantial'' in amount as required by Regulation 1595(a)(5)(A)(2). Claimant argues that the $2,897 received for the nineteen sales is not ''substantial'' when compared to the $820,815 attributable to the final sale of the hotel's furniture and equipment (plus an additional $56,394 for the hotel's linen). Relying on *Ontario Community Foundation Inc.* v. *State Board of Equalization* (1984) 35 Cal.3d 811, claimant contends that the Court struck down former Regulation 1595(a)(3) upon which the *Hotel Del Coronado* decision was based.

[1] All further references to Regulations are to Sales and Use Tax Regulations.

PRATT NORTH PLAZA ASSOCIATES (Contd.)

There is no dispute that claimant made three or more sales within the twelve month period immediately preceding the sale of the business. Nor is there any dispute that the property sold is of a type regularly used in hotel operations. Claimant states that, since the dollar amount of proceeds from sales of used linens, towels, bedding, and furniture during the twelve month period preceding the sale of the hotel business was not ''substantial'', the Department erred in denying claimant the benefit of the ''occassional sale'' exemption. Claimant construes Regulation 1595(a)(5)(A)(2) as focusing exclusively on the dollar amounts of sales, with no concern for the number or frequency of sales once three sales for a substantial amount have been made.

OPINION

The Board concludes that the second paragraph of Regulation 1595(a)(1) applies to the service enterprises discussed in Regulation 1595(a)(5)(A)(2), and that, therefore, an operator of a service enterprise is required to hold a seller's permit when, in any twelve month period, more than two sales for substantial amounts are made of tangible personal property used in the service enterprise, or a substantial number of sales for relatively small amounts are made of tangible personal property used in the service enterprise. The Board further concludes that $400 is a ''substantial'' amount for purposes of Regulation 1595, but leaves for another day the question of whether amounts less than $400 are ''substantial''.

The Board also finds that the similar ''character'' of the sales made before the sale of the business, as discussed in Regulation 1595(a)(4)(C) and in *Northwestern Pacific Railroad Company* v. *State Board of Equalization* (1943) 21 Cal.2d 524, is satisfied as all the sales were sales of beds, mattresses, box springs, linens, and other hotel furnishings.

Clamant's reliance on *Ontario Community Foundation* is misplaced because therein the court held that there had only been a single sale of the hospital equipment and furnishings, not a series of such sales. The court went on to explain that the taxable result in *Hotel Del Coronado* was based on there being a series of twelve sales prior to the final liquidation sale.

Under the above facts, the claimant, in liquidating the hotel fixtures and equipment, made three sales in substantial amounts during the relevant twelve month period, i.e., there were two sales in excess of $400 plus the final sale of the business. Therefore, claimant was required to hold the seller's permit for its activities in selling the hotel fixtures and equipment, and the claim for refund is denied.

Done at Sacramento, California, this 28th day of October, 1993.

Brad Sharman, Chairman

Ernest J. Dronenburg, Jr., Member

Windie Scott, Member

Attested by: Burton W. Oliver, Executive Director

MARK PULVERS

Although agreements with his clients did not specify that petitioner was acting as an agent, petitioner's advertising made it sufficiently apparent to customers that they were ordering food from a specific restaurant and that petitioner was merely delivering the food, not reselling it.

Petitioner's delivery charges are for services not related to the sale of the food and are therefore not subject to tax.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of MARK PULVERS *Petitioner*

Appearances:

For Petitioner:	Mark Pulvers Petitioner
	Elizabeth Insko Reifler Attorney at Law
	Steve Thompson Business Consultant
For Appeals Review Section:	Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Gary Jugum Assistant Chief Counsel
	John L. Waid Staff Counsel
	Glenn Bystrom Deputy Director

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination of sales and use taxes in the amount of $6,154.95 and 10 percent penalty of $615.51 filed by Mark Pulvers on November 27, 1991.

The issues are: (1) whether petitioner is a retailer, and (2) whether petitioner's delivery charges for the delivery of food and videos are includible in the measure of tax.

On or about August 1, 1989, petitioner Mark Pulvers, dba Room Service of Marin, began the delivery of food, beverages, and videos to the public by a ''Restaurant/Room Service Agreement'' (agreement) with various restaurants and stores. The agreements provided in relevant part that each restaurant would prepare and package food ordered through petitioner; that each restaurant was solely responsible for its menu and prices, and would give petitioner timely notice of any menu or price changes; that each restaurant was responsible for the freshness and quality of its food; that only petitioner would be engaged for the delivery of the restaurant's food; and that petitioner would be responsible for

MARK PULVERS (Contd.)

advertising and marketing the restaurant's products by production of a brochure, and its distribution to potential customers.

Petitioner bulk-mailed his brochures to homes and businesses within specified areas. Each brochure advertised the menus of the restaurants, as well as the delivery and pickup of videos, and instructed customers to place their order with petitioner by store/restaurant and item number. The brochure also stated the amount of the delivery charge.

When a customer called petitioner with a food order, petitioner phoned in the order to the restaurant or restaurants chosen by the customer. The restaurant prepared and packaged the food, which was picked-up and delivered by petitioner's driver. If a video was ordered the customer was required to have an account with the store and to call and reserve the video. The customer then called petitioner to pick up the video and deliver it along with the customer's food order. When petitioner's driver picked up the food from a restaurant, the driver signed a receipt acknowledging the items picked-up and their sales price.

Upon delivery, the driver prepared a receipt stating the cost of the food, and video, if any, applicable sales tax reimbursement (computed only on the price of the food and video), and the $5 delivery charge. The customer paid petitioner's driver. All checks and credit card charges were made payable to petitioner. Petitioner then deducted an agreed percentage of the menu price and his delivery fee, and remitted the balance to the restaurant or restaurants. Thereafter, the restaurant (or video store, if petitioner delivered a video) reported the sales in their respective tax returns and paid the applicable tax due on the food and video rentals. Neither the restaurant nor the video store included the delivery charges in their measure of tax, nor was tax reimbursement collected on the delivery charges. Petitioner contends that, at all times during the period in question, he held himself out as providing a service as an agent of the restaurants and stores for which he delivered food or videos.

Revenue and Taxation Code section 6012 provides in relevant part that the term ''gross receipts'' means the total amount of the sale price, of the retail sale of retailers, without any deduction for the cost of transportation of the property, except as excluded by other provisions. Section 6015 provides in relevant part that a ''retailer'' includes every seller who makes any retail sale or sales of tangible personal property; and every person engaged in the business of making sales for storage, use, or other consumption. The term ''agent'' is defined as one who represents another, called the principal, in dealings with third persons. (See Civil Code, § 2295; see also *Workman* v. *City of San Diego* (1968) 267 Cal.App.2d 36, 38.)

Whether an agency relationship exists is determined by the relationship of the parties as they in fact exist under their agreement or acts. (*Rezos* v. *Zahn & Nagel Co.* (1926) 78 Cal.App. 728; see also *Nizuk* v. *Georges* (1960) 180 Cal.App.2d 699.) In determining the existence of an agency relationship, an examination of the agreement as a whole and the supporting facts and circumstances is necessary. (See *Anderson* v. *Badger* (1948) 84 Cal.App.2d 736, 742.)

MARK PULVERS (Contd.)

Petitioner argues that he always acts on behalf of a specified principal when food or a video is ordered, and this fact is always understood by all parties to the transaction. While this is not evidence of disclosure to a customer of an agency agreement between petitioner and the restaurants and video stores (clients), we nonetheless find from the facts and circumstances herein that petitioner held himself out as providing a pick-up and delivery service on behalf of his clients under the dba Room Service of Marin, and not as the retailer of the items delivered.

Petitioner entered into ''Restaurant/Room Service Agreements'' with his clients that fully set forth the duties and obligations of the parties to the agreement. The clients being solely responsible for such activities as the preparation and packaging of the food, the timely notice of any menu or price changes, and the freshness and quality of its food, placed the control of an exceedingly important item of the transaction in the hands of the clients. Petitioner's responsibility was limited to such activities as the advertising and marketing of the client's products by production of a brochure and its distribution to potential customers, and the delivery of the food or video to the customer. As set forth above, petitioner could not pick up a video for a customer that did not have an account with the store. Even though all checks and credit card charges were made payable to petitioner, nevertheless petitioner was acting on behalf of the restaurants in delivering the food.

We conclude that an agency relationship existed between petitioner and his clients, and that such clients were the retailers of the products. Although the agreements did not specify petitioner was acting as an agent, petitioner's advertising made it sufficiently apparent to customers that they were ordering food from a specific restaurant, and petitioner was merely delivering the food, not reselling it.

We further conclude that petitioner's delivery charges are services not subject to sales and use taxes. Petitioner's customers paid petitioner for the service of delivering the food. The retailers did not charge or collect the delivery fee. We believe petitioner operated a delivery service, paid for by the customers, and the charge is not part of the restaurants' gross receipts.

Although we find the existence of an agency relationship between petitioner and its clients from the facts and circumstances herein, petitioner and similarly situated taxpayers should prepare written agreements that adequately describe the responsibilities of the parties, and make it clear that they are acting as the agent of their clients in the marketing and delivery of their products.

For the reasons expressed in this opinion, the petition for redetermination was granted.

Adopted at Culver City, California, this 13th day of December, 1994.

Brad Sherman, Chairman
Ernest J. Dronenburg, Jr., Member
Windie Scott, Member
Attested by: Burton W. Oliver, Executive Director

RANDOLPH COMPUTER

Maintenance charges under leases in which the lessee must contract with the lessor for maintenance services are subject to tax.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of RANDOLPH COMPUTER CORP. *for Redetermination of Sales and Use Tax*

Appearances:

For Petitioner: George D. Brodigan
Attorney at Law

John Winters
Vice President

For Staff: Robert H. Anderson
Tax Counsel

OPINION

This petition is for redetermination of sales and use tax in the amount of $29,683.63 for the period February 1, 1966 to December 31, 1969.

Randolph Computer Corporation (RCC) is a lessor of automatic data processing equipment manufactured by International Business Machines Corporation (IBM). Petitioner's lease receipts are subject to tax under the Sales and Use Tax Law. The issue presented is whether certain amounts paid by petitioner's lessees for maintenance of the leased equipment are includable in the measure of tax.

Petitioner ordinarily gives its lessees an option of entering into either a ''net'' lease or a ''gross'' lease. The terms of the ''net'' lease agreement with respect to maintenance are as follows:

> ''Customer shall enter into and maintain in force with IBM or such other company as RCC shall designate (subject to customer's consent) or approve in writing at any time during the term of each Schedule subject hereto, a maintenance agreement covering the machines thereunder. Customer will use its best efforts to cause the machines subject to each Schedule to be kept in good working order in accordance with the provisions of the maintenance agreement in effect during the respective term thereof. Subject to United States security regulations, Customer agrees to make the machines available for maintenance in accordance with the provisions of the applicable maintenance agreement. Customer shall provide satisfactory evidence to RCC that Customer has entered into and is continuing to maintain in full force and effect said maintenance agreement at its sole cost and expense, all in accordance with the provisions of this Section.
>
> ''Customer shall pay, at its own expense, all maintenance and service charges whether such charges are incurred under the applicable maintenance agreement or otherwise, and in addition will pay expenses, if any, of customer engineers in connection with maintenance and repair services, provided

RANDOLPH COMPUTER (Contd.)

however, that Customer's liability therefor shall not exceed IBM's charges for such services as in effect from time to time.''

The terms of the ''gross'' lease agreement with respect to maintenance are as follows:

''RCC shall enter into and maintain in force a maintenance agreement covering the machines. Customer will use its best efforts to cause the machines to be kept in good working order in accordance with the provison of the applicable maintenance agreement in effect during the term of each Schedule subject hereto. Subject to United States security regulations, Customer agrees to make the machines available for maintenance in accordance with the provisions of the maintenance agreement.

''RCC's liability for payment of charges under any maintenance agreement in force pursuant to this Agreement shall be limited to the minimum monthly maintenance charge or the amount indicated on the applicable Schedule, whichever is lower. Customer shall pay, at its expense, all maintenance and service charges in excess of RCC's liability therefor, whether such charges are incurred under the maintenance agreement or otherwise, and in addition will pay expenses, if any, of customer engineers in connection with maintenance and repair services, provided however, that the amount Customer is required to pay shall not exceed IBM's charges for such services as in effect from time to time.''

Petitioner entered into a special lease agreement with one customer, Lockheed Aircraft Corporation, which contained provisions regarding maintenance that were different from either of the above-quoted agreements. These provisions were as follows:

''RCC agrees to appoint the Customer as its agent to obtain maintenance service from IBM for machines covered by this Agreement. The Customer agrees to include the leased machines either within the coverage of its basic maintenance agreement for purchased machines with IBM or within the coverage of IBM's standard commercial maintenance contract. Upon receipt of evidence of payment by Customer, RCC shall reimburse the Customer (in the form of a credit against monthly rental charges) for an amount equal to IBM's January 1, 1967 minimum monthly maintenance charges for the machines. The Customer shall pay all other service charges. In the event the machines covered by this Agreement are removed from the State of California, upon mutual agreement of Customer and RCC, RCC shall enter into and maintain in force an IBM Maintenance Agreement covering the machines in lieu of the Customer obtaining maintenance services as described above, provided however, in the event RCC shall do so, (i) RCC shall pay no more for maintenance of the machines than the IBM April 1, 1967 minimum monthly maintenance charges therefor, and (ii) RCC's obligation to reimburse Customer for minimum monthly maintenance charges as aforesaid shall terminate.''

The lease agreement between petitioner and Lockheed pertained to IBM equipment already located on Lockheed's premises and maintained by IBM

RANDOLPH COMPUTER (Contd.)

which equipment had been owned by IBM, but which petitioner was in the process of purchasing from IBM. Petitioner states that what Lockheed actually wanted was a ''net'' lease, but that since most of petitioner's leases were at that time ''gross'' leases, it billed Lockheed the same as it would have under a ''gross'' lease. Petitioner explains that Lockheed was appointed as petitioner's agent in order to protect petitioner's ownership interest in the equipment.

Petitioner has collected from its customers and paid tax measured by the ''minimum monthly maintenance'' charges under its ''gross'' leases, but has not collected or paid tax measured by the ''excess'' maintenance charges under those leases, nor has it collected or paid tax with respect to any of the maintenance charges under its ''net'' leases or its lease with Lockheed. The determination here in question asserts tax measured by the ''excess'' maintenance charges under the ''gross'' leases and all maintenance charges under the Lockheed lease.

Sales and Use Tax Regulation 1502(k) (18 Cal. Admin. Code § 1502(k)) directly relates to the question of whether the maintenance charges are includable in the measure of tax. It provides as follows:

> ''Where services, such as . . . maintenance services, are provided to those who purchase automatic data processing and related equipment, on a mandatory basis as an inseparable part of the sale or taxable lease of the equipment, charges for the furnishing of the services are includable in the measure of tax from the sale or lease of the equipment whether the charges are separately stated or not. Where the purchaser or lessee has the option to acquire the equipment either with or without the services, charges for the services may be excluded from the measure of tax from the sale of the equipment.''

Under the facts of petitioner's case, the lessees other than Lockheed had the option of acquiring the equipment either with or without maintenance services provided directly or indirectly by petitioner, i.e., they had the choice of entering into a ''net'' lease, under which they would pay a third party for maintenance services, or a ''gross'' lease, under which they would pay petitioner for maintenance services provided by a third party with whom petitioner contracted. Pursuant to the regulation, accordingly, none of the maintenance charges under either a ''net'' lease or a ''gross'' lease with lessees other than Lockheed are includable in the measure of tax.

The Lockheed lease is less readily classified because of its peculiar provisions and the unusual circumstances surrounding it. Petitioner's own explanation, however, indicates that while Lockheed wanted a ''net'' lease, petitioner took it upon itself to prescribe a ''gross'' lease, under which Lockheed acted as petitioner's agent in providing maintenance services. Accepting petitioner's explanation of why this was done, the fact remains that the agreement was cast as it was for petitioner's own purposes. The evidence does not support a finding that Lockheed was given an option to contract for the maintenance services on its own behalf with a third party. We conclude that the maintenance services under the Lockheed lease were provided by petitioner, as the principal, on a mandatory basis as an inseparable part of the taxable lease of the equipment, and that

RANDOLPH COMPUTER (Contd.)

Lockheed did not have the option to acquire the equipment otherwise. Therefore, the maintenance charges under that lease were includable in the measure of tax.

The maintenance charges under those leases other than the Lockheed lease are to be deleted from the measure of tax. The deletion, however, is not to include maintenance charges under ''gross'' leases as to which petitioner has collected tax from its lessees. Pursuant to Section 6902 of the Revenue and Taxation Code petitioner may, within six months after this determination becomes final, file a claim for refund of tax paid with respect to maintenance charges under ''gross'' leases, other than the Lockheed lease. The granting of such claim will depend upon satisfactory assurance that the amount of the tax will be returned to the lessees from whom petitioner collected it.

Done at Sacramento, California, this 3rd day of January 1974.

George R. Reilly, Chairman
John W. Lynch. Member
William M. Bennett, Member
Richard Nevins, Member
Attested by: W. W. Dunlop, Executive Secretary

REDWOOD RANCH & VINEYARDS, INC.

Buds, when removed from grapevines and grafted to rootstock, do not constitute "seeds" within the meaning of section 6358(c) of the Revenue and Taxation Code.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of REDWOOD RANCH & VINEYARDS, INC. *for Redetermination of Sales Tax*

Appearances:

For Petitioner: Wallace J. S. Johnson
In pro per.

For Staff: Joseph Manarolla
Tax Counsel

MEMORANDUM OPINION

This petition is made pursuant to Section 6561 of the California Sales and Use Tax Law by Redwood Ranch & Vineyards, Inc. (hereinafter Petitioner) against a deficiency determination of sales tax in the amount of $154.79 plus penalty for failure to file returns in the amount of $15.50, plus statutory interest.

The issue presented by the petition is whether buds when removed from grapevines and grafted (budded) to rootstock constitute ''seeds'' within the meaning of Section 6358(c) of the Revenue and Taxation Code.

Petitioner is a corporation, operates a cattle ranch and maintains vineyards for the production of varietal grapes.

REDWOOD RANCH & VINEYARDS, INC. (Contd.)

The Board granted Petitioner 30 days in which to file a brief and a statement from Professor Harold Olma of the University of California at Davis. Neither the brief nor the statement have been submitted within the granted time. The opinion therefore is based on the record.

During the years 1972 and 1973 Petitioner made sales of buds for the propagation of grapevines.

To obtain the buds a section of grapevine containing five or six buds (bud wood) is cut from an established grapevine. The bud wood is then placed in cold storage until needed. Petitioner's representative stated that the buds were primarily for Petitioner's own use to expand its own vineyard. Some of the buds, however, were sold to persons interested in propagating grapevines of the represented varieties. The sales price of the bud wood was based on the number of buds on the section of bud wood sold. It is these sales that are protested here.

Use of the buds requires that they be cut from the bud wood and notched into a rootstock. This procedure is known as ''budding''. The rootstock, with the included buds, is covered with earth. The buds eventually sprout and become a new grapevine.

The staff has regarded the bud as not constituting a ''seed'' within the meaning of Section 6358(c) of the Revenue and Taxation Code.

Petitioner contends that buds are seeds entitled to the exemption from taxation granted by Section 6358(c).

Section 6358(c) provides that seeds and annual plants, the products of which ordinarily constitute food for human consumption or are to be sold in the regular course of business, are exempted from sales and use taxes.

Petitioner, however, argues that the bud, when removed from the bud wood and grafted (budded) to the rootstock for the purpose of propagating varietal grapevines, constitutes a seed by reason of its function. Under this reasoning, however, cuttings and bulbs also would qualify as seeds. We do not believe that the exemption statute can be so broadly construed. The Board consistently has ruled that cuttings and bulbs do not constitute seeds within the meaning of Section 6358(c) even though they are capable of producing a growing plant. A seed, unlike a bud, is self-sustaining and does not require support for growth from a cutting or established rootstock.

Buds by definition are distinguishable from seeds. Webster's New Third International Dictionary (Unabridged) contains the following:

> ''Bud (N) A small lateral or terminal protuberance on the stem of a plant consisting of an undeveloped shoot made up of rudimentary foilage leaves or floral leaves or both overarching a growing point and often protected by specialized bud scales; an incompletely opened flower. . . . ''
>
> ''Seed (N). Something that is sown; the fertilized and ripened ovule of a seed plant comprising a miniature plant usually accompanied by a supply of food enclosed in a protective seed coat often accompanied by auxiliary structures and capable under suitable conditions of independent development into a plant similar to the one that produced it.''

REDWOOD RANCH & VINEYARDS, INC. (Contd.)

R. W. Adriance and F. R. Brison, Propagation of Horticultural Plants, 2 ed. (1955), contains the following:

> ''Buds. A bud is a growing point, surrounded by small partially developed leaves. It is in reality a rudimentary stem in a state of dormacy or limited growth protected by an envelope of bud scales.''
>
> ''Seeds. True seeds have three essential parts in common which become their distinguishing characteristics. (1) The embryo is the most important component of a seed. It is the living plant developed from the fertilized egg cell, and its growth has been restricted by the maturity of the seed. Its parts are radicle [rudimentary root], plumule [rudimentary shoot], and one or two catyledons [rudimentary leaves], (2) Stored food is another component of a seed. It is deposited in the seed while it is still on the mother plant, (3) the testa is the outside covering forming the protective coat of the seed.''

This authority also states at page 222 under the heading ''Grape'' in relevant part as follows:

> ''the grape can be propagated in several different ways—from seeds, from cuttings, by layering and by budding and grafting.
>
> Because of the extreme variability of seedling plants of grape, commercial viticulturalists never grow a vineyard from seed.''

Further relevant definitions are as follows:

> ''budding is a type of grafting in which a plant bud is inserted under the bark of the stock.''
>
> ''Grafting is the horticultural practice of uniting parts of two plants so that they grow as one. . . . The part grafted onto the stock or rooted part may be a single bud, as in budding, or a cutting that has several buds.''

It is clearly stated that propagation by budding is not propagation from seed and implicit in the statement is the fact that buds and seeds are not synonymous. Our research has revealed no authority for the proposition that a bud is a seed whether in common usage or in the technical or botanical sense.

The Standard Encyclopedia of Horticulture touches on the common usage of the term in its definition of seed as follows:

> ''a seed is a ripened embryo and its integuments and storage supplies resulting from the fertilization of a flower. In general literature and common speech, a seed is that part of the plant which is the *outcome of flowering* and which is used for propagating the species. In the technical or botanical sense, however, the seed is the ripened ovule. The seed contains an embryo, has one or more leaves (catyledons), a bud or growing point (plumule) and a short descending axis (caulicale). From the caulicle or stemlet the radicle or root develops. This embryo is a minute dormant plant. Each embryo is the result of a distinct process of fertilization in which the pollen of the same or another flower has taken part.'' (Emphasis added.)

A bud is not the ''outcome of flowering'' and clearly does not meet the definition of a seed even under common usage.

REDWOOD RANCH & VINEYARDS, INC. (Contd.)

The statute expressly exempts ''seed'', not buds or a combination of buds and rootstock. It is well established that statutes granting exemption from taxation are to be strictly construed. *(Good Humor Co.* v. *State Board of Equalization,* 152 Cal.App.2d 873).

In our view buds do not constitute seed within the meaning of Section 6358(c) of the Revenue and Taxation Code.

For the reasons expressed in this opinion, the matter is redetermined without adjustment.

Done at Sacramento, California, this 3rd day of February, 1976.

William M. Bennett, Chariman
George R. Reilly, Member
Richard Nevins, Member
Attested by: W. W. Dunlop, Executive Secretary

RHODIA, INC.

Commingling and regeneration of spent sulfuric acid is a taxable exchange of reconditioned property.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claims for Refund Under the Sales and Use Tax Law of RHODIA, INC.

Appearances:

For Claimant:	Joseph Vinatieri Attorney
	William Vande Wetering, CPA
	Thomas Benner Product Manager, Rhodia, Inc.
For Sales and Use Tax Department:	Sharon Jarvis Supervising Tax Counsel
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

Claimant filed two claims for refund for amounts paid on sales and use tax returns on its transactions with its customers for regenerating spent sulfuric acid. The Sales and Use Tax Department acknowledged the two claims for the periods April 1, 1998 through March 31, 2000.

Claimant's customers are petroleum refiners. Over time, the refiners' fresh sulfuric acid used in their refinery operations becomes contaminated or spent and no longer serves its intended purpose. When this occurs, the refiners transport the

RHODIA, INC. (Contd.)

spent acid, containing approximately 90 percent sulfuric acid, from their refineries to claimant. At its facilities in California, claimant commingles the spent acid with spent acid from other refiners. The refiners retain title to their spent acid, and claimant does not use deficiency accounts or credit accounts. When claimant receives spent acid, it also provides the refiners with other fresh or regenerated sulfuric acid, so that the refiners have sulfuric acid continuously available for use in their refinery operations. The refiners and claimant repeat this process approximately every two days.

Claimant's regeneration process includes: heating the spent sulfuric acid to a gaseous form; breaking it down to sulfur dioxide (a non-acid), carbon dioxide, and water; removing contaminants; and replenishing the product with fresh sulfur derivatives. Claimant buys the fresh sulfur derivatives tax-paid.

Claimant contends that its regeneration of spent sulfuric acid is a nontaxable repair or reconditioning service pursuant to California Code of Regulations, title 18, section 1546. Claimant's services refit the sulfuric acid for the same use by the refiners for which it was originally produced. Claimant does not make any ultimate change in the sulfuric acid and uses only the same types of chemical components as originally in the sulfuric acid.

The Department contends the process is a salvage and manufacture process, for the fabrication of a new product subject to tax. The Department argues that after claimant removes the contaminants, it uses the recovered sulfur dioxide as a raw material, together with the sulfur derivatives it purchased and other chemical components, to make new sulfuric acid. Alternatively, the Department contends that even if claimant's process were a repair or reconditioning operation rather than a fabrication of a new product, tax would nevertheless apply to claimant's transactions with the refiners. The transactions would constitute a taxable exchange of used for reconditioned similar property, pursuant to section 1546, paragraph (b)(4).

OPINION

We find that the outcome in this matter is controlled by section 1546. As relevant to this opinion, section 1546 provides in part:

"(b) [¶] . . .[¶]

(4) EXCHANGE OF USED FOR RECONDITIONED SIMILAR PROPERTY. If the method of repairing or reconditioning certain tangible personal property involves commingling property delivered to a repairman or reconditioner with similar property so that the customer receives repaired or reconditioned property which may not be the identical property delivered to the repairman or reconditioner but which is exactly the same kind of property or derived from exactly the same kind of property as that so delivered, tax applies to the amount charged by the repairman or reconditioner for the repaired or reconditioned property."

We conclude that claimant's transactions do not constitute the fabrication of a new product. Claimant received contaminated sulfuric acid, removed the impurities, added tax-paid sulfur derivatives, and returned to the refiners

RHODIA, INC. (Contd.)

regenerated sulfuric acid, unchanged in its chemical composition. The process described above is more analogous to repair than fabrication, despite the fact that claimant reduced the sulfuric acid to its chemical components, since the purpose was solely to remove the impurities.

However, the transactions are taxable as exchanged reconditioned property under section 1546, paragraph (b)(4). Claimant commingles spent sulfuric acid from different refiners and also provides them with fresh sulfuric acid from previously commingled resources. Because of this commingling, it is irrelevant that the refiners may have attempted to retain title to their spent acid. Deny the claims for refund.

Adopted at Sacramento, California, on May 30, 2002.

John Chiang, Chair
Johan Klehs, Member
Dean Andal, Member
Claude Parrish, Member

LAWRENCE ROBERTS

The form of trees or shrubs will, of course, change to some extent through growth after they are acquired. Nevertheless, in cases where trees or shrubs are in containers when acquired and remain in the same containers when they are subsequently leased or rented, they are leased in substantially the same form within the meaning of section 6006(g)(5) of the Revenue and Taxation Code.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of LAWRENCE ROBERTS *for Redetermination of Sales Tax*

Appearances:

For Petitioner:	Lawrence Roberts In pro. per.
For Staff:	T. P. Putnam Tax Counsel

MEMORANDUM OPINION

This petition is made pursuant to section 6561 of the Sales and Use Tax Law by Lawrence Roberts against a determination of sales and use tax in the amount of $483.84 plus a negligence penalty in the amount of $48.38 for the period January 1, 1964, to December 31, 1966. The amount of tax in dispute is $349.80.

Petitioner is engaged in landscape gardening and selling and renting trees and shrubs. The determination against petitioner was based primarily on the ground that petitioner failed to pay tax on the rentals of the trees and shrubs. Petitioner contends that the rentals are not subject to tax because he paid sales tax reimbursement at the time he acquired the trees and shrubs and that he rented them in substantially the same form as they were in when he acquired them. He

LAWRENCE ROBERTS (Contd.)

contends that the trees and shrubs were in pots or cans when he acquired them and that he kept them in the same containers when he rented them to customers.

With certain exceptions, leases or rentals of tangible personal property were defined as sales and became subject to tax on August 1, 1965. The exception pertinent here is in section 6006(g)(5) which provides in part that ''sale'' does not include a lease of tangible personal property in substantially the same form as acquired by the lessor if he has paid sales tax reimbursement measured by the purchase price of the property.

Because petitioner's records for the period in question have been destroyed by fire, it is difficult to establish whether or not he paid sales tax reimbursement when he acquired the trees and shrubs here involved. It is also difficult to establish whether or not the trees and shrubs remained in substantially the same form when he rented them to customers. Based on petitioner's testimony, however, and on records showing his practices for periods after the fire occurred, we have found that he did pay sales tax reimbursement when he acquired the trees and shrubs and that he kept them in the same containers that they were in when he acquired them.

The form of trees or shrubs will, of course, change to some extent through growth after they are acquired. It is our opinion, nevertheless, that in cases where trees or shrubs are in containers when acquired and remain in the same containers when they are subsequently leased or rented, they are leased in substantially the same form within the meaning of section 6006(g)(5).

Although there remains a small deficiency in tax, we find that the deficiency was not due to negligence.

For the reasons expressed in this opinion, the tax is hereby redetermined in the amount of $134.04 and the negligence penalty is deleted.

Done at Sacramento, California, this 7th day of January 1969.

John W. Lynch, Chairman

Richard Nevins, Member

George R. Reilly, Member

Paul R. Leake, Member

Attested by: D. D. Bell, Acting Executive Secretary

S C W, INC.

Advertising service books of printed advertising illustrations accompanied by sets of mats which the publisher may use after it has selected from the display book are not periodicals within the meaning of Section 6362 even though the books are prepared and distributed monthly. Rather, the advertising service companies are the consumers of the mats and books. This is a long continued interpretation incorporated in Sales Tax General Bulletin 55-12 and is entitled to great weight since it is not clearly erroneous.

S C W, INC. (Contd.)

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matters of the Petitions for Redetermination and Claims for Refund of S C W, INC., and STAMPS-CONHAIM-WHITEHEAD, INC.

Appearances:

For Petitioners: Kindel and Anderson and
John W. Armagost
Attorneys at Law

For Staff: John H. Knowles
Tax Counsel

MEMORANDUM OPINION

S C W, Inc., is the successor of Stamps-Conhaim-Whitehead. Both taxpayers petition for redetermination pursuant to section 6561 and claim refunds pursuant to section 6901 of the California Sales and Use Tax Law. S C W, Inc., petitions against the determination of $18,138.16 plus interest and claims a refund of $1,139.03. Stamps-Conhaim-Whitehead petitions against the determination of $6,644.76 plus interest and claims a refund of $1,943.52. The period involved in the two matters extends from January 1, 1962, to June 30, 1965.

The taxpayer (the singular is used throughout for clarity) argues that the advertising service books and the mats which it furnishes its clients are periodicals within section 6362 of the California Sales and Use Tax Law and ruling 50. In the alternative, the taxpayer contends that it should be treated as a retailer rather than as a consumer for purposes of the tax. It is our opinion that the taxpayer cannot prevail on either ground.

The taxpayer has operated for many years as an advertising service company. Each month it prepares and distributes to its newspaper clients an advertising service book and mats containing advertising art work for use by the newspaper in printing advertising. The proof book is used to illustrate the advertising impressed on the mats. It also is used in making paste-ups which are photographed and reproduced by the photo-offset method of printing. When this method is used, the newspaper does not ordinarily receive the mats. At times, newspapers receive extra proof books for an additional charge. There is no dispute that in such cases the taxpayer is selling tangible personal property and is subject to tax on the additional charge, except where the exemption for the interstate commerce applies.

The taxpayer varies its charge for furnishing the art work depending on the circulation of the newspaper; the larger the newspaper, the greater the charge. The taxpayer is able to do this because a newspaper, by subscribing to the books and mats, does not need to maintain an art department. All of the taxpayer's art is copyrighted. The taxpayer and a single New York competitor are substantially the sole sources of advertising books and mats.

The taxpayer's first contention that its books and mats are exempt periodicals cannot be sustained. A periodical is defined by ruling 50 as a publication ''each issue of which contains news or information of general interest to the public, or

to some particular organization or group of persons.'' The books and mats do not contain news or information, but art work exclusively. An accompanying booklet does contain columns of printed matter, but it is clear that its purpose is not to spread news or information. The printed columns are supplied for incorporation into the newspaper along with the advertising.

The taxpayer's alternative contention is that this board has mistakenly classified advertising service companies as consumers of the materials going into the production of the books and mats and that we are required under governing legal principles to treat it as a retailer for sales tax purposes. Such treatment would result in a downward adjustment of the tax in question because the taxpayer would be able to claim the interstate commerce exemption (see ruling 55) as to the great majority of its sales, which would more than offset the increased measure of tax on its California sales. A corresponding increase in tax on the sales of the taxpayer's New York competitor would also be a result of the proposed reclassification.

The board's long-standing interpretation has been that advertising service companies are rendering services and are consumers rather than retailers of the property they furnish in connection with those services. In 1946, this board's sales tax counsel advised the taxpayer that it was the consumer of the materials used in furnishing services to newspapers. In 1955, this interpretation was incorporated in Sales Tax General Bulletin 55-12, as follows:

''1. *Advertising Service Companies (Cut and Copy Service)*

These companies contract for a fixed sum per month (Usually based on population or circulation) to supply to publishers an advertising book service, consisting of a book or books of printed advertising illustrations which the publishers could use. The books are accompanied by a complete set of mats which the publisher may use after he has made the selection from the display book. The service also includes suggested ad combinations, layouts, copy and fashion information.

''The advertising mat service companies are the consumers of the mats and books. Accordingly, tax applies with respect to the sale to the companies of the mats or books, or if the companies prepare the mats or books, to the sale of the materials becoming a component part of the mats or books.''

From 1946 until 1964, the taxpayer followed the interpretation that it was a consumer rather than a retailer of the books and mats which it furnished.

Persons who render services are properly considered as consumers rather than retailers of property which they furnish incidentally to their rendition of the services. This concept has long been recognized in the regulations of the board. (See rulings 1 through 11.) For example, the board has treated as consumers advertising agencies furnishing original manuscripts and statistical and other information (ruling 2); dentists who furnish plates, inlays and other property to their patients (ruling 5); and mailing houses which furnish mailing lists (ruling 7.5).

S C W, INC. (Contd.)

In *General Electric Co.* v. *State Board of Equalization*, (1952) 111 Cal.App.2d 180 [244 P.2d 427], at pages 186 and 188, the court made the following observations concerning the board's authority to distinguish between sales of services and sales of property and to make general classifications:

> ". . . When we come to structures and fixtures attached to realty, the statute does not define, with minute precision, the division line between the sale of tangible personal property, and the sale of services. Close questions are bound to occur. The Legislature has seen fit to leave the determination of these questions to the state board under its rule-making power. In adopting rules that are intended to apply generally it is obvious that borderline cases will occur where it will be very difficult to ascertain whether the sale is primarily of property or of services.
>
> * * *
>
> "Rule-making bodies have a wide discretion in exercising the power to classify. As long as the rule works uniformly upon all persons in a class and the classification is based upon some natural or reasonable distinction, the classification is not invalid."

Although the court was concerned with ruling 11 and its application to construction contractors, the court's observations are applicable to other cases in which distinctions must be made between sales of services and sales of property.

It should be observed, moreover, that the consistent administrative construction of a statute for many years by the agency charged with its administration is entitled to great weight and should not be overturned unless it is clearly erroneous. (*Lucas* v. *Hesperia Golf & Country Club*, 255 Cal.App.2d_. [255 A.C.A. 278, 286])

In developing and regularly supplying to its clients ideas and materials to be used for advertising purposes, the taxpayer undoubtedly provides services even though it furnishes tangible personal property. Although the question of whether it is selling services or is selling property is arguable, we have taken the position for the last 22 years that it is selling services. We do not believe that this long-continued interpretation can be characterized as clearly erroneous. It is our conclusion that the taxpayer uses the property here involved in rendering services and that it is a consumer and not a retailer of the property.

Consistent with the foregoing conclusion, a reaudit has been conducted pursuant to which the determination of tax in the amount of $18,138.16 against S C W, Inc., is hereby reduced to $13,090.04 and the determination of tax in the amount of $6,644.76 against Stamps-Conhaim-Whitehead is reduced to $4,401.72. In all other respects, the petitions and claim for refund are denied.

Done at Sacramento, California, this 8th day of October 1968.

Richard Nevins, Chairman
George R. Reilly, Member
John W. Lynch, Member
Attested by: H. F. Freeman, Executive Secretary

SCHOLASTIC BOOK CLUBS, INC.

A mail order book seller sold books to students through teachers who acted as the seller's agents. The seller was liable for collection of use tax on its sales of bonus items to the teachers for classroom use. But the seller was also entitled to an equal offsetting cash discount on those sales. The bonus items sold were premium merchandise, not compensation to the teachers.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination of SCHOLASTIC BOOK CLUBS, INC. *under the Sales and Use Tax Law*

Appearances:

For Petitioner:	Mr. George Isaacson Attorney Brann & Isaacson, LLP
For Sales and Use Tax Department:	Ms. Janice Thurston Senior Tax Counsel
For Appeals Section:	Mr. John Abbott Supervising Tax Counsel

MEMORANDUM OPINION

This opinion is on a petition for redetermination in the amount of $166,082.71 in tax for the period January 1, 1990 through March 31, 1993. The Board heard this case on July 29, 1999, in Sacramento, California.

Petitioner, Scholastic Book Clubs, Inc., is a Missouri corporation that sold books to students and teachers (and school librarians) throughout the United States, including California. It shipped the books sold by common carrier from its distribution center in Missouri to the teachers at their schools, and collected California use tax on its sales to California students and teachers. For purposes of use tax collection, the teachers acted as agents for petitioner. They received mail order catalogs from petitioner, distributed order forms to their students, collected orders and payments, and sent the orders and payments to petitioner. (See *Scholastic Book Clubs, Inc.* v. *State Bd. of Equalization* (1989) 207 Cal.App.3d 734, 737; Rev. & Tax. Code, sec. 6203, subd. (c)(2)).

When students and teachers purchased books from the mail order catalogs, the teachers who sent in the orders earned bonus points that were later redeemable for books and other educational items, either from petitioner's book catalogs or its bonus catalogs. Petitioner awarded the bonus points at one point or more per dollar of orders placed, kept track of each teacher's bonus points, and provided the bonus catalogs. When the teachers accumulated sufficient bonus points to qualify for the items redeemed, petitioner shipped the bonus point items to the teachers at their schools.

During the prior audit period at issue in *Scholastic Books, Inc.*, supra, petitioner placed no restrictions on the teachers' use of items purchased with bonus points; the items could be used in the classrooms or for the teachers' personal use. Also, the types of items available through bonus points included items intended for personal use. However, during the current audit period

SCHOLASTIC BOOK CLUBS, INC. (Contd.)

petitioner did place restrictions on the teachers' use of the bonus point items; they were intended for use exclusively in the classrooms (or school libraries). On page 2 of the bonus catalogs, it stated:

> "Scholastic Bonus Points and Classroom Bonuses are awarded for the exclusive and mutual educational benefit of all participating students, their teachers, classrooms, and schools."

Petitioner's bonus point program is a sales promotion plan in which premiums consisting of bonus books and other educational items are provided for use in the classroom or school library by students and teachers. Petitioner incurs no expense in relation to the bonus items until the teachers order the items.

Title 18, California Code of Regulations, section 1671, Trading Stamps and Related Promotional Plans, paragraph (b)(2), describes a promotional plan in which the "retailer incurs no expense with relation to the premium until such time as the customer obtains the premium. The retailer purchases the premium and delivers it to his customer in exchange for the required quantity of indicia." Under this type of promotional plan, the application of sales and use tax is described in paragraph (e) of the regulation:

> "(e) PLAN DESCRIBED IN (b)(2).
>
> "(1) CASH DISCOUNT. The retailer incurs the expense with relation to the premium at the time he delivers the premium to his customer. The retailer is entitled to a cash discount deduction at the time he delivers the premium to his customer. The amount of the cash discount deduction shall be the selling price of the premium as determined by Paragraph (e) (2) below . . . .
>
> "(2) SALE OF PREMIUM. The delivery of premium merchandise by the retailer to his customer in exchange for a prescribed number of units of indicia constitutes a taxable retail sale of the premium merchandise. . . . The selling price is the sales price to the retailer of the premium merchandise."

Under this provision, the retailer is liable for tax on its sales of premium merchandise measured by its cost to purchase the merchandise, but the tax is offset by the cash discount on those sales, equal to the measure of tax on the sales.

OPINION

We conclude that the petition should be granted. During the audit period, petitioner did not provide compensation, in the form of bonus items, to the teachers in return for them acting as its agents. Rather, petitioner engaged in a promotional plan in which the teachers received premiums in exchange for the bonus points the teachers had accumulated by placing orders with petitioner. Petitioner expressly limited the use of the bonus items to classroom and school uses, and not to personal uses by the teachers. Tax applies as described in Regulation 1671, paragraph (e)(2) above.

Done at Sacramento, California, this 7th day of October, 1999.

Dean F. Andal, Member
Claude Parrish, Member
Marcy Jo Mandel, Member*

* For Kathleen Connell, per Government Code section 7.9.

HAROLD SOMMER

The fact that a vessel is undocumented, has no masts, engine or steering facilities, and is being used as a residence does not preclude its classification as a vessel under section 6273 of the Revenue and Taxation Code.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of HAROLD SOMMER *for Redetermination of Use Tax*

Appearances:

For Petitioner: Mr. William E. Vaughn
Attorney at law

For Staff: Mr. J. Kenneth McManigal
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merit of a petition for redetermination of use tax in the amount of $750 plus statutory interest determined against petitioner as the result of his purchase of *Wander Bird*, a German-built schooner, on February 17, 1970. At that time, *Wander Bird* was not documented as a vessel, it had no masts, it had no engine, it had no steering facilities, it was being used as a residence, it was in a leased berth, and it was moored to shore by cables. According to the records of the Marin County Assessor, *Wander Bird* was tangible personal property, not real property.

Revenue and Taxation Code Section 6367 exempts from sales and use taxes the gross receipts from occasional sales of tangible personal property and the storage, use, or other consumption in this state of tangible personal property, the transfer of which to the purchaser is an occasional sale. However, the exemption does not apply to the gross receipts from the sale of, or to the storage, use, or other consumption in this state of a vessel as defined in Article I (commencing with Section 6271) of Chapter 3.5 of Part 1 of Division 2 of the Revenue and Taxation Code, such part being known as the Sales and Use Tax Law.

With certain exceptions not applicable herein, Section 6273 defines ‘‘vessel’’ to mean any boat, ship, barge, craft, or floating thing designed for navigation in the water. Section 6291 provides that the use taxes imposed with respect to the storage, use or other consumption in the state of vessels as defined in Section 6273 are due and payable by the purchaser at the time the storage, use or other consumption of the vessel first becomes taxable.

Being a schooner, *Wander Bird* was a vessel as defined by Section 6273. Do the facts that when petitioner purchased *Wander Bird* it was not documented as a vessel, it was in a modified state, and it was being used as a residence dictate a conclusion that *Wander Bird* was no longer a vessel for purposes of the Sales and Use Tax Law? We think not. Being a boat, ship, barge, craft, or floating thing designed for navigation in the water, it was and remains a vessel as defined by the section.

HAROLD SOMMER (Contd.)

To the contrary, it has been contended that *Wander Bird* was a floating item of tangible personal property, not a vessel. In support thereof, reference has been made to the ''traditional admiralty concept of 'vessel'', and various authorities and court decisions pertaining thereto have been advanced. However, petitioner has cited no authority for the proposition that ''vessel'' as defined in Section 6273 for purposes of the Sales and Use Tax Law must coincide with such concept or any other concept of ''vessel'' for purposes of other laws, nor are we aware of any. Rather, the power of a state to make classifications of persons or property for the purpose of taxation is very broad, and if a classification of persons or occupations made for the purpose of imposing taxes is founded on natural, intrinsic or fundamental distinctions which are reasonable in their relation to the object of the Legislature and otherwise, they will be deemed to be valid (*Henry's Restaurant of Pomona, Inc.* v. *State Board of Equalization*, 30 Cal.App.3d 1009; *Roth Drug, Inc.* v. *Johnson*, 13 Cal.App.2d 720). In the absence of a showing to the contrary, it is assumed that there are good grounds for the classification, and the act will be upheld (*Roth Drug, Inc.* v. *Johnson*, supra). Petitioner has made no such showing to the contrary with respect to Section 6273.

Assuming, however, that resort to the traditional admiralty concept of ''vessel'' is appropriate, we would still conclude that *Wander Bird* was a vessel. Under that concept, the test is whether *Wander Bird* was a watercraft or other artificial contrivance used, or capable of being used, as a means of transportation on water (1 U.S.C.A., § 3).

In support of the contention that the *Wander Bird* was not such a craft or contrivance, petitioner has cited *Evansville and B.G. Co.* v. *Chero Cola Co.*, 271 U.S. 19; *The Schooner Frances McDonald*, 254 U.S. 242; and *Murray* v. *Schwartz,* 175 Fed.2d 72. The latter two cases did not concern the definition of a vessel at all, but rather the question of whether certain vessels were subject to admiralty and maritime jurisdiction. The *Evansville* case involved a wharfboat which had a concrete lined bottom, was connected with city water, electrical and telephone systems, and was used as an office and warehouse. The court, emphasizing the permanent nature of its location, concluded that it was not practically capable of being used for transportation.

We believe the status of *Wander Bird* is more nearly reflected by the following cases, holding that the watercraft involved were vessels: *The Art,* 17 Fed.2d 446 (moored without machinery or sails and used as a residence); *Pleason* v. *Gulfport Shipbuilding Corporation,* 221 Fed.2d 621 (moored to a dock with engines, propellers, and steering mechanism removed, and used for processing shrimp); and *Campbell* v. *Loznicka,* 181 Fed.2d 356 (bomb target boat that was a hull capable of being towed.)

Accordingly, it is concluded that the transfer of *Wander Bird* to petitioner was not an exempt occasional sale, that use tax applied as the result of petitioner's storage and use of *Wander Bird* in California, and that petitioner was liable for such tax.

HAROLD SOMMER (Contd.)

Petitioner has establish, however, that the purchase price of *Wander Bird* was less than that used as the measure or tax in the determination. The use tax, accordingly, shall be reduced to $500 based on a purchase price of $10,000.

Done at Sacramento, California, this 1st day of May 1974.

George R. Reilley, Chairman
John W. Lynch, Member
Richard Nevins, Member
Attested by: W. W. Dunlop, Executive Secretary

EDWARD SPURLOCK

A buyer cannot issue a resale certificate to the seller and then deny the validity of the resale certificate because it failed to include all of the elements of a valid resale certificate pursuant to Revenue and Taxation Code section 6093 and Regulation 1668(b).

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of EDWARD SPURLOCK dba SPURLOCK'S GENERAL CABINET *for Redetermination under the Sales and Use Tax Law*

Appearances:

For Petitioner:	Mr. Abe Golomb Consultant
For Business Taxes Appeals Review Section:	Mr. Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	Dennis Fox Supervising Tax Auditor

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination of use tax of $570.16 which was heard, taken under consideration, and later decided by the Board on January 12, 1993, in Sacramento, California.

Petitioner is a maker of wooden cabinets and desks. Desks and some cabinets, were sold without installation; however, under lump-sum construction contracts, petitioner installed most of the cabinets he sold.

Petitioner made sixteen (16) purchases during the audit period, from one California seller of lumber that went into the cabinets and desks. At or near the time of the first purchase, petitioner issued to the seller a resale certificate (copy attached) in the pre-printed form suggested in Sales and Use Tax Regulation 1668(b). Petitioner wrote the following entries in blanks on the resale certificate:

1. His firm name, Spurlock's General Cabinet.
2. His valid seller's permit number.

EDWARD SPURLOCK (Contd.)

3. His signature.
4. His address.
5. His telephone number.
6. The date of the certificate.

The pre-printed portion of the resale certificate signed by petitioner stated in part, that:

"... in the event any of such property is used for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, it is understood that I am required by the Sales and Use Tax Law to report and pay for the tax, measured by the purchase price of such property."

Petitioner made no entries, but left blank, the spaces on the resale certificate provided for the following:

1. The description of petitioner's business.
2. The name of the seller.
3. The description of the property to be purchased.
4. The location at which petitioner signed the certificate.

Given the above facts, the Sales and Use Tax Department's audit concluded that petitioner owed use tax on the purchases of the lumber consumed by petitioner in performing lump sum contracts to furnish and install non-prefabricated cabinets. Petitioner contended that only the seller is liable for (sales) tax on the sales of lumber consumed by petitioner. Petitioner further argues that he is not liable for (use) tax on the purchases as the resale certificate was invalid because it did not include all of the elements required for a valid resale certificate pursuant to Revenue and Taxation Code section 6093 and Regulation 1668(b).

Given the above facts, the Board concluded that petitioner is liable for use tax on the purchases. The petitioner cannot first issue a resale certificate to the seller and then deny the validity of the resale certificate. Under Revenue and Taxation Code section 6244(a), by issuing the resale certificate, the petitioner represented to the seller that he was purchasing property for the purpose of reselling it.

Done at San Diego, California, this 29th day of June, 1993.

Brad Sherman, Chairman

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Windie Scott, Member

Attested by: Burton W. Oliver, Executive Director

TRW INC.

Where a taxpayer contracts to design, develop and deliver a new product, the cost of property used in the design and development stages is subject to tax and the property cannot be purchased for resale.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of TRW INC. *for Redetermination of Sales Tax*

Appearances:

For Petitioner:	Mr. Norman A. Zilber Attorney
	Mr. James A. Amdur Attorney
For Staff:	Mr. Philip R. Dougherty Tax Counsel

MEMORANDUM OPINION

This petition for redetermination by TRW Inc., was made pursuant to Section 6561 of the Revenue and Taxation Code from determinations of the Board that additional sales and use taxes were due from TRW Inc., for the periods January 1, 1964 through December 31, 1967 and January 1, 1968 through June 30, 1968. TRW Inc., is joined in the petition by Communications Satellite Corporation appearing as a real party in interest.

Petitioner is a corporation engaged in manifold activities, among them the sale of aerospace equipment and services. On May 7, 1966, petitioner contracted with Communications Satellite Corporation (hereinafter Comsat) to design and build two engineering model communication satellites (unit price $5,042,364), one prototype model communication satellite (unit price $5,716,794), six flight communication satellites (unit price $585,577), and associated equipment, ground stations, test equipment, plans and specifications, and provide launch services, operating instructions, and progress systems engineering (unit prices were also specified for each of these items), all for a fixed total contract price of $31,985,000.

The contract (CAS-SA-6) and the detailed work statement attached to it were written with the careful attention to itemization and detail familiar to government contractors. The contract specified the sequence of the performances and a unit price for each of the performances, provided for four interim payments relating to the two engineering model satellites and for progress payments at 90 percent of the contractors' incurred costs but limited to the unit prices for the models specified in the contract. The contract contained additional provisions relating to delivery, taxes, title, arbitration, etc. An itemized work statement further detailing TRW's duties was appended to the contract.

The satellites to be built by TRW were to have five times the capacity of the previous generation of communication satellites and were to employ a number of significant advances in technology. A substantial amount of research and development was necessary to produce a systems design which would meet the

TRW INC. (Contd.)

performance specifications required by Comsat. Under the contract, TRW was specifically required to successively fabricate and demonstrate a first and second engineering model satellite and then one prototype model satellite to prove to Comsat that the design of the systems and performance of the produced hardware complied with Comsat's requirements.

After the Comsat contract was entered, TRW's engineering staff developed detailed design specifications for the satellites.

TRW then subcontracted the development and production of some subsystems of the satellites to various aerospace companies. The subcontracts and their work statements followed the structure of the prime contract. Each of the subcontracts called for the subcontractors to fabricate and sell to TRW, successively, engineering model satellite subsystems, prototype model satellite subsystems, and later flight model satellite subsystems along with the associated subsidiary equipment, test plans, and services relating to each subsystem. Each subcontract specified unit prices for each performance.

The bulk of the research and development effort for the project was antecedent to the completion of the engineering and prototype models. As in the prime contract, the largest portion of TRW's payments to its subcontractors were for the unit prices the subcontracts listed for the engineering and prototype model satellite subsystems.

When the subcontractors supplied a model's subsystem component, the petitioner's personnel assembled that model according to the developed specifications with the assistance of the subcontractors' personnel. The models were tested by the teams as part of the continuing process of the development of the satellite system. The assembled models were also used to develop the surrounding services and equipment, test data, test equipment, and information required of TRW by the prime contract. Additionally, each model was used to demonstrate to Comsat the progress of the project and the effectiveness of the system design and materials. Those demonstrations were specific performances required of TRW by the prime contract.

The prime contract also required TRW to pass title to the engineering and prototype satellites when the models were accepted by Comsat. The acceptances were informal. During the contract's performance, one engineering model was shipped to Comsat's receiving station at Andover, Maine. The prototype model was shipped to Comsat at Cape Kennedy. Comsat used the models it received to generate test signals and as exemplars of the engineering technology of that generation of its equipment. Apparently, one engineering model has never been accepted and remained in TRW's possession for some time after the contract was completed until TRW shipped it to a Comsat warehouse in Delaware.

The prime contract and its work statement and the following subcontracts and their work statements were amended several times during the course of the project to clarify engineering specifications, create work terminology, add launching services, and increase the number of flight spacecraft. The additional duties were related to additional specific prices. No change was made in the basic structure of the contracts.

TRW INC. (Contd.)

The Board's determinations of the sales and use taxes due from TRW included use tax imposed on TRW's use of the engineering and prototype satellite subsystems in its performances under its prime contract with Comsat. The full sales prices stated in the subcontracts for the production and sale of each of the subsystems was used as the sales price upon which the use tax must be calculated.

Among the bases for redetermination urged by petitioner are that (1) the sole purpose of the prime and subcontracts was the production of flight satellites for a fixed total price, so the sale and use of the models are not separately cognizable and the prices paid to subcontractors for the models should be considered part of the price paid for flight spacecraft purchased solely for resale to Comsat; that (2) if the model subsystems are distinct from the flight subsystems for use tax purposes, TRW did not store, use, or otherwise consume the model subsystems within the meaning of the Sales and Use Tax Law, and no tax computed upon the purchase of the model subsystems is due; and that (3) if the subsystems were stored, used, or consumed by TRW within the meaning of the Sales and Use Tax Law, only the part of the price attributable to the cost of the models' hardware, as distinct from the cost of research and development, may be used as a sales price of the model subsystems for use tax purposes.

Before exploring petitioner's contentions in detail, we will set out some basic principles. Sales and use taxes apply to the sale and use of tangible personal property (Rev. & Tax. Code §§ 6051, 6201), and not to the mere performance of a service. In distinguishing between the sale of tangible personal property and the sale of a service, it is necessary to determine the true object of the transaction, i.e., is the real object sought by the buyer the ''service'' per se, or the finished article produced by the service? (*Albers* v. *State Board of Equalization,* 237 Cal.App.2d 494). Tax does not apply to a sale of tangible personal property for the purpose of resale in the regular course of business (Rev. & Tax. Code §§ 6051, 6007), nor to the use of property purchased for resale, unless the use goes beyond the mere retention, demonstration, or display of the property while holding it for sale in the regular course of business (Rev. & Tax. Code §§ 6094, 6244).

When examining contracts of the particular kind before us, it is necessary to distinguish contracts for research and development from contracts for the manufacture of a ''custom-made'' item. A contract for research and development is primarily a contract for information, which is regarded as an intangible. Such a contract is a service contract rather than one for the sale of tangible personal property even if the information is to be transferred on drawings, blueprints, memoranda, etc. If a research and development contract calls for the transfer of a prototype (previously used to develop the data called for in the service portion of the contract) the transfer of it is a sale of tangible personal property without any credit for the tax or tax reimbursement paid on its materials. But the measure of tax arising from the sale or the use of that prototype is not the whole contract price since the primary purpose of the whole contract was one for the service of developing information.

TRW INC. (Contd.)

In a contract for the fabrication of a custom-made item, the research and development necessary for the fabrication of the item is incidental to the primary purpose of the contract, which is the production of the item rather than the information it embodies. The price of the item which must measure the tax may not be reduced by the cost of the research and development necessary to produce it.

To determine if a contract was for the sale of services or the sale of tangible personal property, the language of the contracts must be read in the light of the surrounding circumstances and the parties' purposes and actions.

In this case the prime contract appears to be one in which the purpose was the development and sale of custom-made items, the flight spacecraft and their attendant equipment and services, which were to be used in Comsat's business operations. Under the prime contract, the models were incidental to the research and development phase of the production of the flight systems. Comsat never accepted one of the models. Comsat accepted the other two and used them as satellite simulators to generate typical signals for a short time. The evident concern of the prime contract with the models is the schedule with which they were to be produced and the adequacy of the demonstration performances conducted by TRW for Comsat rather than the models' subsequent delivery to and use by Comsat.

Although the subcontracts' language and organization was similar to that of the prime contract, the purposes of parties were different. TRW's purpose was not to use flight spacecraft (as distinguished from the models), but to adequately perform its duties under the prime contract. TRW could not contract away all of the research and development. After the subcontractors had developed and fabricated those subsystems which were their responsibility, TRW assembled them and did that additional research and development in the integration of the subsystems and procedures, and the development of the test information programs and procedures for which it was still responsible under the prime contract. Unlike Comsat, TRW required the model subsystems as specific tangible personal property, which it used in the research and development phase of the prime contract. If the assembled models failed in TRW's hands, the preceding research and development by its subcontractors was irrelevant. So while the purchase of the models may be considered incidental to the purchase of the flight craft insofar as Comsat was concerned, the purchase of the model subsystems was as primary as the purchase of the flight subsystems insofar as TRW was concerned.

The principle that tangible personal property is not purchased for resale if it is purchased for use in a research and development phase of a contract for the production and sale of a custom-made item is well established, cf. *Alabama* v. *Thiokol Chemical Corp.* (1970) 246 So.2d 447, affd. 246 So.2d 454. But the case presented by this petition is a demonstration of the additional principle that the property purchased from a subcontractor for use in a research and development effort of the purchaser is an end item to the researcher who so uses it, whether the property is a product of special research and development by the subcontractor or is of pre-existing and standard design.

TRW INC. (Contd.)

The question remains whether the purchase prices of the model subsystems are the unit prices attributed to them in the subcontracts, specifically, whether the research and development costs reimbursed in the unit prices for the models should be attributed to both the models and the flight satellites. If that is proper, only that part of the unit price attributable to the direct fabrication of the models plus the prorated share of the research and development should be considered the actual price TRW paid for the purchase of the model subsystems.

Petitioner argues that the high unit prices in the prime and subcontracts were not the result of any agreement that the models were worth more than the flight systems, but were simply a recognition that most of the research and development had to be performed during the development of the system, which occurred during the model phase of the prime contract. The research and development, says petitioner, was too costly for TRW and its subcontractors to carry until full contract performance and so that part of the models' prices intended to pay for the research and development effort should be attributed in part or whole to the flight craft. The contracts, however, in addition to the high unit prices stated for the models in comparison to those stated for the flight satellites had articulated provisions for progress payments based on incurred cost. The structure of the contracts appears to have been capable of adjustment to lower the price of the models and extend the provisions of the progress payments to the preceding research and development if that had been a more accurate expression of the parties' intent. Consequently, it appears that the agreement's specified prices for the subsystems were not intended as a disguised progress payment. TRW's adequate performance of the model phase of the prime contract would earn it the largest portion of the total prime contract price, so it is understandable that TRW agreed to a correspondingly high price for the purchase of the model subsystems were the vehicles for that performance. Since the contracts do not appear to be ambiguous or inaccurate expressions of the agreed prices, and under the circumstances the pricing terms could hardly be attempts to avoid taxes, there is no basis for revising the pricing terms for the purposes of the Sales and Use Tax Law.

Accordingly, we redetermine the amount due without change in the amount of tax.

Done at Sacramento, California, this 19th day of March 1975.

John W. Lynch, Chairman

William M. Bennett, Member

George R. Reilly, Member

Richard Nevins, Member

Attested by: W. W. Dunlop, Executive Secretary

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SUSAN LORIE TYLOCK

A produce shipper may purchase for resale disposable temperature recording devices for the sole purpose of shipping the devices with produce the shipper sells. The produce shipper or the carrier does not make a taxable use of the devices merely by starting them in this state.

If, pursuant to its contract with the purchaser, the produce seller ships the device with the produce to an out-of-state point, the produce shipper's sale of the device is an exempt sale in interstate commerce under Revenue and Taxation Code section 6396.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination under the Sales and Use Tax Law of SUSAN LORIE TYLOCK *Petitioner*

Appearances:

For Claimant:	David Colker Attorney
For Business Taxes Appeals Review Section:	Susan Wengel Assistant Chief Counsel
For Sales and Use Tax Department:	Gary J. Jugum Assistant Chief Counsel Warren Astleford Senior Tax Counsel

MEMORANDUM OPINION

Before the Board in this case is the application of sales tax to petitioner's charge for disposable temperature recording devices (temperature recorders) which petitioner sold to shippers of perishable agricultural produce. The function of the temperature recorders petitioner sold was to track and record temperatures of the produce while it was in possession of a common carrier who transported the produce in a conveyance (e.g., vehicle or rail car) from the produce shipper to the produce purchasers.

The temperature recorders are capable of recording temperatures over a period of 10, 15, or 30 days. Generally, the produce purchaser uses the data from the temperature recorder to verify whether the common carrier maintained the proper temperature inside the vehicle or rail car in which the carrier transported the produce. For example, if the produce were to reach the destination damaged, the purchaser could determine from recordings made by the temperature recorder whether the damage was caused by the carrier's failure to maintain proper temperature levels in the vehicle or freight car during transportation.

In a typical transaction, petitioner purchased a temperature recorder from the manufacturer and sold it to a produce shipper who had a contract to supply produce to an out-of-state buyer. The produce shippers separately listed on their invoice to the purchaser the charge for the temperature recorder and the charge

SUSAN LORIE TYLOCK (Contd.)

for the produce. In all cases in issue, the produce shippers were required to ship the produce and the temperature recorders to a point outside of this state. The produce shippers contracted with the common carriers to perform that transportation. The produce shipper marked the recorders for identification purposes and either started the recorders when the recorders were placed on the carrier's conveyance or merely transferred possession of the temperature recorder to the carrier's employee who would start the recorder on the conveyance.

If the carrier delivered the produce to the out-of-state destination damaged, the produce purchaser shipped the temperature recorder to the recorder's manufacturer which interpreted the recorded temperature data. The produce buyer could then determine if it had evidence to support a claim for damages against the carrier for not maintaining the proper temperature of the perishable goods. If the produce arrived at the destination undamaged, the produce buyer could discard the temperature recorder or could return it to the manufacturer for a ''refund allowance''. The recorders were never returned to petitioner, the produce shipper, or the carrier.

OPINION

We conclude that petitioner's sales of temperature recorders to produce shippers were nontaxable sales for resale; that is, the produce shipper purchased the temperature recorders to sell to the purchaser of the produce to whom the produce and the temperature recorders were shipped. We found that neither the produce shipper nor the carrier made a use of the temperature recorders merely by starting them in this state on the carrier's vehicle or rail car.

We conclude that the produce shippers were required, pursuant to their contract with the produce buyers, to ship the temperature recorders to a point outside of this state and did so ship the temperature recorders to the out-of-state point by means of the common carrier of the produce. Accordingly, the produce shippers' sales of the temperature recorders to the out-of-state produce buyers were exempt sales in interstate commerce under Revenue and Taxation Code section 6396.

Done at Sacramento, California, this 25th day of February, 1999.

Dean F. Andal, Member

Claude Parrish, Member

John Chiang, Member

UNITED STATES SALES CORPORATION

An exterior envelope printed with advertising for goods or services may itself qualify as a printed sales message.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of UNITED STATES SALES CORPORATION

UNITED STATES SALES CORPORATION (Contd.)

Appearances:

For Petitioner:	George Isaacson Attorney
For Sales and Use Tax Department:	David Levine Tax Counsel IV
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination for the period July 1, 1993 through September 30, 1998. At the Board hearing, among other issues, petitioner protested a portion of a determination related to its purchases of exterior envelopes for mailing printed sales messages.

Petitioner, a corporation, operated a mail order company that solicited sales through sweepstakes promotions mailed to potential customers. It purchased printed sales messages (advertising materials) from various printers, who delivered the printed sales messages to a mailing house, Mail Marketing, a subsidiary of petitioner. Petitioner purchased the envelopes from vendors other than the printers from whom it purchased its printed sales messages; these vendors also delivered the envelopes to the mailing house. The mailing house then inserted the printed sales messages in the envelopes and mailed the envelopes with the printed sales messages by U.S. mail to petitioner's prospective customers.

Petitioner contends that its purchases of exterior envelopes are exempt from the use tax because, among other things, the envelopes themselves qualify as printed sales messages. Petitioner contends its purchases of these envelopes are exempt when delivered as required by California Code of Regulations, title 18, section 1541.5, Printed Sales Messages.

The Department argues that the primary purpose of the envelopes was to act as containers. Based on this, the Department argued that subdivision (b)(7) of section 1541.5, which covers envelopes sold as containers with the contents, was the exclusive provision applicable to the purchase of exterior envelopes.

OPINION

Subdivision (a)(1) of section 1541.5 defines the term ''printed sales messages'' as follows:

> ' ''PRINTED SALES MESSAGES' means and is limited to catalogs, letters, circulars, brochures, and pamphlets printed for the principal purpose of advertising or promoting goods or services. The term includes such items as department store catalogs, brochures advertising automobiles and vacations, circulars advertising professional services, and coupon books. The term does not include campaign literature and other fund-raising materials, stationery, reply envelopes, except as provided for in (b) of this regulation, order forms, sales invoices, containers for sample merchandise, newspapers or periodicals,

UNITED STATES SALES CORPORATION (Contd.)

calendars, notepads, cash register tapes, or directories unless they meet the principal purpose of advertising or promoting goods or services.''

Subdivision (b)(7) of section 1541.5 provides:

''Tax does not apply to charges for containers, such as envelopes or wrapping paper, when sold with the printed sales messages for shipment or delivery, or when sold to persons who place the printed sales messages in the container and sell the printed sales messages together with the container.''

Petitioner's purchases of the envelopes are not exempt under subdivision (b)(7) of section 1541.5 because the vendors who sold the envelopes to petitioner did not sell them as containers for printed sales messages also sold by those vendors. The question presented is whether subdivision (b)(7) precludes an exterior envelope from independently qualifying as a printed sales message under subdivision (a)(1). We conclude that an exterior envelope may independently qualify as a printed sales message.

We conclude that under these facts, the envelopes are themselves printed sales messages because they meet the principal purpose of advertising or promoting goods or services within the meaning of subdivision (a)(1). Since they were delivered in the manner required by section 1541.5, petitioner's purchases of the envelopes are exempt from tax. The petition should be granted as to this issue.

Adopted at Sacramento, California, on August 1, 2001.

Claude Parrish, Chairman
John Chiang, Member
Johan Klehs, Member
Dean F. Andal, Member
Marcy Jo Mandel, Member*

* For Dr. Kathleen Connell, pursuant to Government Code section 7.9.

VARIAN ASSOCIATES

Where the taxpayer had an ongoing obligation to deliver property outside California, storage in California by the taxpayer after title transfer did not cause the loss of the exemption for property sold in interstate commerce.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

DECISION OF THE BOARD

In the Matter of the Claim for Refund under the Sales and Use Tax Law of VARIAN ASSOCIATES *Claimant*

Appearances:

For Claimant: Joseph A. Vinatieri
Attorney
Douglas Burns
Sales Tax Manager

VARIAN ASSOCIATES (Contd.)

For Business Taxes Appeals Review Section:	Donald J. Hennessy Assistant Chief Counsel
For Sales and Use Tax Department:	G. A. Bystrom Principal Tax Auditor
	Ronald Dick Senior Staff Counsel

This Decision deals with a claim for refund of sales taxes paid with respect to sales of linear accelerators which were ultimately shipped to points outside California. The taxes were paid pursuant to an audit covering the period from January 1, 1981 through March 31, 1984. The Board heard and granted this claim at the regular meeting of the Board on October 26, 1993 in Sacramento, California.

Claimant entered into written contracts which required claimant to deliver the accelerators to points outside California. As to the sales in question, the customers were not ready to receive the accelerators when claimant completed the manufacture. Prior to shipment to points outside California, claimant, with the concurrence of its customers, shipped the accelerators to a storage location in California. Storage was at a third party warehouse which made a charge to claimant for the storage space. Claimant was reimbursed for storage charges by claimant's customers. Claimant did, in fact, ultimately ship the accelerators to points outside California via common carrier.

At issue is whether claimant's obligation to ship the accelerators outside California remained in effect after claimant and the customers agreed to the shipment of the accelerators to the California storage site, particularly in view of documentation stating that shipment to the storage site constituted shipment by claimant for contractual purposes. The Board found that claimant had an ongoing contractual obligation to deliver the property to points outside California after the storage. This ongoing obligation was sufficient to allow claimant to claim exemption for these sales pursuant to Revenue and Taxation Code section 6396, and subdivision (a)(3)(B) of Sales and Use Tax Regulation 1620 which provides in pertinent part:

> "Sales tax does not apply when the property pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer . . ."

The Sales and Use Tax Department argued that the agreements between claimant and the customers to ship the accelerators to the storage site in California relieved claimant from any further obligation to ship the equipment outside California. The Board concluded that, although title and risk of loss to the accelerators passed to the customers on shipment to the storage location, claimant

VARIAN ASSOCIATES (Contd.)

was still contractually obligated to ship the accelerators outside California. The factors upon which the Board relied in reaching this conclusion included:

1. The accelerators were ultimately shipped outside California by claimant.

2. The original contracts required claimant to ship the accelerators outside California.

3. The customer was obligated to pay for all shipping costs.

4. Claimant paid for the first 60 days of storage.

5. Claimant was responsible for the selection of the storage facility.

6. Claimant periodically inspected and performed required maintenance on the accelerators in storage.

7. The customers would not ordinarily know the location of the storage facility.

Adopted at Sacramento, California, this 30th day of June, 1994.

Matthew K. Fong, Member

Ernest J. Dronenburg, Jr., Member

Windie Scott, Member

Attested by: E. L. Sorensen, Jr. for Executive Director

TONY VOLPA

Partnerships are generally viewed for sales and use tax purposes as distinct entities. Where title to property is held by a partnership, and the property is leased to a third party, the partnership, rather than the individual partners, is the lessor.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of TONY VOLPA dba VOLPA BROTHERS *for Redetermination of Sales Tax*

Appearances:

For Petitioner: Mr. J. J. Jurkovich
Business Associate

For Staff: Mr. T. P. Putnam
Assistant Chief Counsel

MEMORANDUM OPINION

Taxpayer filed a petition for redetermination of use taxes on rental receipts for the period April 1, 1966, to December 31, 1968, in the amount of $2,961.98 plus statutory interest.

Taxpayer is a road construction contractor who also is engaged in the sale of road construction materials. From time to time taxpayer rents construction

TONY VOLPA (Contd.)

equipment and a batch plant which he owns to third parties, including joint ventures in which taxpayer is a participant. It is a tax on the receipts from these rentals which is at issue here.

The history of the ownership of the construction equipment shows that it was originally purchased sometime prior to 1960 by Tony Volpa and his brother Joseph Volpa as partners, and tax was paid on the purchase price to their vendor. Title to this construction equipment was held by a partnership in which the brothers were 50-50 partners.

In 1960 Joseph Volpa died, and his widow, Sally, inherited his interest in the partnership. Title to the equipment was then held by a partnership which was formed consisting of Tony Volpa and Sally Volpa. On January 7, 1966, Sally Volpa sold her interest to Tony Volpa without payment of tax and Tony Volpa now holds title to the equipment as an individual.

The asphalt batch plant was purchased tax paid in 1960. Title was held jointly by the partnership of Tony Volpa and Joseph Volpa (50%) and by H. R. Langworthy as an individual (50%). After Joseph Volpa's death, title to the batch plant was held by the partnership formed by Tony Volpa and Sally Volpa (50%) and by H. R. Langworthy (50%), as an individual.

In 1965 H. R. Langworthy sold his 50 percent interest to Mr. J. J. Jurkovich. This was a taxable transfer and tax was reported and paid. Title to the batch plant was now held by a partnership consisting of Tony Volpa and Sally Volpa (50%) and J. J. Jurkovich as an individual (50%). Tony Volpa, Sally Volpa, and J. J. Jurkovich formed a partnership and their interests in the partnership were the same as their ownership interests in the batch plant. The batch plant was used in the partnership and also rented to third parties, but it was not contributed to the partnership, i.e., title did not pass to this new partnership but continued to be held in joint ownership. Jurkovich maintained records of his 50 percent ownership on his personal books and Tony Volpa and Sally Volpa on the books of their partnership.

On January 7, 1966, Sally Volpa sold her interest to Tony Volpa, ex tax. Since that time the batch plant has been owned by Tony Volpa (50%) and J. J. Jurkovich (50%) as individuals, and each carries his 50 percent interest on his personal books.

Sales and Use Tax Ruling No. 70 (California Administrative Code 2070) provides in section (c)(2) that "Tax does not apply to leases of:

* * *

"(F) Tangible personal property leased in substantially the same form as acquired by the lessor or leased in substantially the same form as acquired by a transferor as to which the lessor or transferor has paid sales tax reimbursement pursuant to section 6052 or has paid use tax pursuant to section 6202 or 6203 measured by the purchase price of the property. If tax is not paid at the time the property is acquired, and the lessor desires to pay tax measured by the purchase price, it must be reported and paid with the return of the lessor for the period during which the property is first placed in rental service.

TONY VOLPA (Contd.)

''As used herein 'transferor' means:

''1. A person from whom the lessor acquired the property in a transaction defined as an 'occasional sale' in section 6006.5(b), or

''2. A decedent from whom the lessor acquired the property by will or by law of succession. The lessor who acquired property from a transferor must establish that the property is being leased in substantially the same form as acquired by the transferor and that the transferor paid sales tax reimbursement pursuant to section 6052 or paid use tax pursuant to section 6202 or section 6203 measured by the purchase price of the property.''

This provision is based on Revenue and Taxation Code sections 6006(g)(5) and 6010(e)(5).

The board's audit staff, applying ruling 70, determined that all of the rental receipts from the construction equipment and 50 percent of the rental receipts from the asphalt batch plant, in the period in question, were subject to tax. The receipts from the batch plant attributable to the 50 percent interest purchased tax paid by J. J. Jurkovich in 1965 were determined to be not taxable.

It is taxpayer's contention that the construction equipment and the batch plant were purchased tax paid within the meaning of ruling 70(c)(2)(F) and that tax does not apply to receipts from the rental of the property. Alternatively, he argues that the receipts from fractional interests which have always been held by Tony Volpa, 50 percent in the case of the construction equipment and 25 percent in the case of the asphalt batch plant, should not be subject to tax. We do not agree.

The code and ruling require that the ''lessor'' or his ''transferor'' have paid the tax on the purchase price in order to remove the lease from the definition of ''sale'' and thereby avoid the imposition of tax on the rental receipts.

The ''lessor'' is the person who has leased property to another. Under Revenue and Taxation Code section 6005, the term ''person'' includes both any individual and any ''copartnership''.

While in some instances a partnership is recognized as only an association of individuals having no legal identity outside that of the partners, in other instances it is viewed as an entity separate and distinct from the partners. *U.S.* v. *A & P Trucking Co.* (1959) 358 U.S. 121, 79 S.Ct. 203, 3 L. Ed. 2d 165. *DeMartini* v. *Industrial Accident Commission* (1949) 90 Cal.App.2d 137, 202 P. 2d 828; *Artana* v. *San Jose Scavenger Co.* (1919) 181 Cal. 627, 185 P. 850. In applying the Sales and Use Tax Law we have generally viewed a partnership as a distinct entity.

We hold, therefore, that where title to property is held by a partnership and the property is leased to a third party, the partnership, rather than the individual partners, is the ''lessor'' for purposes of the Sales and Use Tax Law.

This is consistent with the treatment of specific partnership property as property of the partnership rather than of the individual partners under Corporations Code section 15025(a)(c). That section provides that specific

TONY VOLPA (Contd.)

partnership property is not subject to attachment or execution except on a claim against the partnership. See also *Sherwood* v. *Jackson* (1932) 121 Cal.App. 354, 8 P. 2d 943.

When title to property is transferred from the partnership to another partnership or to an individual, that new partnership or that individual becomes the ''lessor''. This new ''lessor'' must pay the tax on his purchase price, or have acquired the property from a ''transferor'' who paid the tax, or collect tax on rental receipts.

In the case of the construction equipment, it was purchased by the partnership entity of Tony Volpa and Joseph Volpa. When Joseph Volpa died, that partnership dissolved by operation of law (Corporations Code section 15031). The property was then held by Tony Volpa as an individual and Sally Volpa as an individual, and was thereafter contributed to a new partnership, a new entity consisting of these two individuals. The construction equipment became partnership property at that time (Corporations Code section 15008). The partnership was the ''lessor'' of the property thereafter. When Sally Volpa sold her interest to Tony Volpa, their partnership ceased to exist, and Tony Volpa became the ''lessor'' of the equipment.

In order for Tony Volpa to thereafter lease the property without collecting tax on rental receipts, he would have to meet the terms of ruling 70(c)(2)(F). This he cannot do. The tax was paid by the partnership of Tony Volpa and Joseph Volpa and not by Tony Volpa the individual.

Assuming, *arguendo,* that the partnership of Tony Volpa and Sally Volpa acquired the property from a ''transferor'', their partnership was not a ''transferor'' as to Tony Volpa, the individual.

Obviously the partnership is not a decedent. Likewise the transfer of the property was not a transfer described in section 6006.5(b). That section reads:

> ''Any transfer of all or substantially all the property held or used by a person in the course of such activities when after such transfer the real or ultimate ownership of such property is substantially similar to that which existed before such transfer. For the purposes of this section, stockholders, bondholders, partners, or other persons holding an ownership interest in a corporation or other entity are regarded as having the 'real or ultimate ownership' of the property of such corporation or other entity.''

The real or ultimate ownership is not substantially similar after the transfer since Tony Volpa formerly owned 50 percent and he now owns 100 percent. Not meeting the provisions of the code or ruling, all rental receipts subsequent to the transfer by Sally Volpa to Tony Volpa are subject to tax.

The same analysis is applicable to the 50 percent interest now held by Tony Volpa in the asphalt batch plant. The 50 percent was purchased tax paid by J. J. Jurkovich and he has continually held that portion in his ownership. He is the lessor as to that half, and the rental receipts attributable to it are not subject to tax.

We are of the opinion that the deficiency was properly determined.

TONY VOLPA (Contd.)

Done at Sacramento, California, this 15th day of September 1970.

George R. Reilly, Chairman
John W. Lynch, Member
Paul R. Leake, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

WFS FINANCIAL, INC.

A financing institution which is not a retailer is entitled to a claim for refund for bad debts on vehicle installment sales agreements under certain conditions.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Claim for Refund Under the Sales and Use Tax Law of WFS FINANCIAL, INC.

Appearances:

For Claimant:	Mr. Peter Larson Attorney At Law Akerman, Senterfitt & Eidson, P.A. Mr. Richard Neilsen Attorney At Law Pillsbury, Madison & Sutro, L.L.P.
For Appeals Section:	Ms. Susan Wengel Senior Tax Counsel
For Sales and Use Tax Department:	Ms. Janice Thurston Senior Tax Counsel

MEMORANDUM OPINION

This opinion considers the merits of a claim for refund of an unspecified amount for the period January 1, 1996, through November 29, 1999. The claim for refund is for bad debt deductions for defaults on certain finance contracts purchased without recourse from various vehicle dealers.

WFS Financial, Inc. and affiliates (Claimant), is a financial institution that during the period at issue did not hold a seller's permit with the Board of Equalization (Board). Claimant described the transactions at issue as follows. The taxable sales were made through installment sales agreements with the dealers. Those dealers made credit sales of motor vehicles at retail, entered into with various California purchasers. Pursuant to these installment sales agreements, the purchasers promised to pay the agreed upon sales price and additional charges, plus sales tax reimbursement, to the dealers. The dealers reported the sales tax to the Board, based on the agreed upon sales price. Under the sales agreements, after receiving credit for down payment amounts, the

WFS FINANCIAL, INC. (Contd.)

purchasers financed the balance due with the dealers at a specified interest rate. The agreements also provided that the dealers held security interests in the vehicles until the purchasers paid off the vehicles. The dealers then, immediately assigned the sales agreements to claimant without recourse. The dealers always intended to assign all the sales agreements to claimant and obtained claimant's approval of the purchasers, the financed balances, and the interest rates before the dealers entered into the sales agreements with the purchasers.

Under the sales agreements, the purchasers continued to pay sales tax reimbursement as part of their installment payments to claimant. If the purchasers defaulted on their finance contracts, claimant had the right to repossess the subject vehicles.

The claim at issue pertains to transactions where the purchasers defaulted and, in most cases, claimant repossessed and resold the subject vehicles. After claimant applied all repossession proceeds and all proceeds from other collection efforts to the amounts still owed by the purchasers, unpaid balances remained. After deeming the unpaid balances to be uncollectable, claimant wrote off the unpaid balances as bad debts for income tax purposes.

The Board's audit staff denied the claim for refund of the alleged bad debts on the basis that only two types of persons who hold seller's permits are entitled to claim bad debt deductions under Revenue and Taxation Code section 6055. One is the retailer who sold the property, and the other is a successor to the business of the original retailer, if the successor purchased the retailer's accounts receivable for full consideration (i.e., not at a discount).

Claimant's position is that it is entitled to a refund under section 6055 for the portions of the unpaid balances that are attributable to sales tax reimbursement that the purchasers failed to pay.

OPINION

Revenue and Taxation Code section 6055 provides, in pertinent part, that:

> "A retailer is relieved from liability for sales tax . . . insofar as the measure of the tax is represented by accounts which have been found to be worthless and charged off for income tax purposes . . . . If the retailer has previously paid the tax, he may, under rules and regulations prescribed by the board, take as a deduction the amount found worthless and charged off. . . ."

The Board has interpreted this statute in California Code of Regulations, title 18, section 1642, subdivision (b)(1), which presently provides, in relevant part, that:

> "(h) SPECIAL SITUATIONS.
>
> "(1) Bad Debt Deductions to Persons Other Than the Retailer.
>
> "(A) A successor who pays full consideration for receivables acquired from the predecessor is entitled to a bad debt deduction to the same extent that the predecessor would have been entitled had the predecessor continued the business."

We find that claimant should be granted a bad debt deduction or refund when all of the following conditions are shown to have occurred:

WFS FINANCIAL, INC. (Contd.)

1. Claimant's representatives were either present on the dealers' premises or immediately available by telephone, fascimile, or computer connection at the time the vehicles in question were sold;

2. Claimant paid full consideration to the dealers for the receivables in question, i.e., claimant did not purchase the receivables at a discount; and

3. The dealers' assignments to claimant of the receivables in question were substantially contemporaneous with the execution of the sales agreements between the dealers and the purchasers.

We find that, in this case, all of the above conditions have been met, and that claimant is a successor that paid full consideration for receivables and qualifies for a bad debt deduction or refund. Because claimant's refund request has not specified an exact amount, we direct the Board's audit staff to review claimant's records to ascertain the amount of the refund in accordance with Regulation 1642. Once this dollar amount is computed, a bad debt deduction or refund should be granted for that amount.

Done at Sacramento, California, this 14th day of December, 2000.

Mr. Andal, Chairman
Mr. Parrish, Member
Mr. Chiang, Member
Ms. Mandel, Member*

* For Kathleen Connell, per Government Code section 7.9.

STANLEY BLAINE WORTHINGTON

The issues presented by petitioner are the same as those presented by its successor Micro Reproduction Services.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition of STANLEY BLAINE WORTHINGTON

Appearances:

For Petitioner: Mr. Stanley Blaine Worthington
in Pro. Per.

For Staff: Mr. W. E. Burkett
Tax Counsel

MEMORANDUM OPINION

This opinion considers the merit of a protested final determination for sales and use taxes in the amount of $921.36, plus statutory interest determined against petitioner for the period September 1, 1964, to December 31, 1965.

The issues presented by the petition are the same as those considered in the memorandum opinion issued on this date on the petition of petitioner's successor, Micro Reproduction Services, Inc., account No. SR AD 14 606017. We do not

STANLEY BLAINE WORTHINGTON (Contd.)

find any material differences between the facts of the two petitions. Accordingly, we conclude that the claim that the taxes were erroneously determined is without merit.

Done at Sacramento, California, this 25th day of March 1969.

George R. Reilly, Chairman
Paul R. Leake, Member
Richard Nevins, Member
Attested by: H. F. Freeman, Executive Secretary

XEROX CORPORATION

Developer used in a photocopy process consists of toner and carrier. The carrier deposits the toner on the photocopies. The presence of the toner in the photocopies is essential to the process. A seller may sell the developer for resale to purchasers who will sell the photocopies, because the toner is incorporated in the photocopies for sale.

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Petition for Redetermination and Claim for Refund under the Sales and Use Tax Law of XEROX CORPORATION, 89002095430, 89002095400

Appearances:

For Petitioner/Claimant:	Eric J. Miethke Attorney
	R. Charles Phillips Manager, Sales and Use Taxes
	Robert W. Gundlach Representative
For Sales and Use Tax Department:	David Levine Tax Counsel IV
For Appeals Section:	John Abbott Tax Counsel IV

MEMORANDUM OPINION

This opinion considers the merits of a petition for redetermination and a claim for refund for the period April 1, 1993 through March 31, 1997. At the Board hearing, petitioner/claimant, hereinafter referred to as petitioner, protested a portion ($453,327) of a determination. It had also paid the tax on the protested amount and filed a timely claim for refund.

Petitioner's photocopy machines used (among other things) developer to produce photocopies. Developer consisted of a combination of toner and a carrier that deposited the toner on the copies. The process required that toner remain on

XEROX CORPORATION (Contd.)

the copies; the carrier did not remain on the copies. Petitioner sold developer to, among other customers, copy shops that produced and sold photocopies to their customers.

The Sales and Use Tax Department assessed tax on the developer petitioner sold to copy shops because it contended that the primary purpose of the developer was for use in the photocopy process, not to become an ingredient or component part of the copy shops' photocopies. Petitioner contended that developer became an integral or component part of the finished product, the photocopies. Since the copy shops sold the copies, petitioner contended that it could accept valid resale certificates for the developer from its copy shop customers and not charge them tax reimbursement.

OPINION

To determine whether property used in manufacturing, producing or processing other items to be sold may be purchased for resale, the Board has adopted Title 18, California Code of Regulations, section 1525 (Regulation 1525). That regulation provides:

"PROPERTY USED IN MANUFACTURING.

(a) Tax applies to the sale of tangible personal property to persons who purchase it for the purpose of use in manufacturing, producing or processing tangible personal property and not for the purpose of physically incorporating it into the manufactured article to be sold. Examples of such property are machinery, tools, furniture, office equipment, and chemicals used as catalysts or otherwise to produce a chemical or physical reaction such as the production of heat or the removal of impurities.

(b) Tax does not apply to sales of tangible personal property to persons who purchase it for the purpose of incorporating it into the manufactured article to be sold, as, for example, any raw material becoming an ingredient or component part of the manufactured article."

In *Kaiser Steel Corp.* v. *State Board of Equalization* (1979) 24 Cal.3d 188, the California Supreme Court, relying on Regulation 1525, held that the purchaser's primary purpose for the raw materials determined the application of tax. If property is purchased primarily as an aid in the manufacturing process, it is taxable despite some portion remaining in the finished product. If property is purchased primarily to incorporate in the finished product, it may be purchased for resale, not for use.

We find that petitioner sold developer to copy shops primarily for the purpose of incorporating the toner into the finished product, the photocopies. The toner was an essential component of the photocopies. The copy shops did not use the developer primarily for the purpose of producing the photocopies. Accordingly, petitioner could accept valid sales for resale from its copy shop customers for the developer. The petition and claim for refund should be granted.

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XEROX CORPORATION (Contd.)

Adopted at Sacramento, California, on March 29, 2001.

Claude Parrish, Chairman

John Chiang, Member

Johan Klehs, Member

Dean Andal, Member

Marcy Jo Mandel, Member*

* For Kathleen Connell, pursuant to Government Code section 7.9.